

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
IN SEATTLE

UNITED STATES OF AMERICA,)	
)	
Petitioner,)	No. CV15-102RSM
)	No. CV15-103RSM
v.)	
)	
MICROSOFT CORPORATION,)	
et al.,)	
)	
Respondents.)	

EVIDENTIARY HEARING

August 25, 2015

BEFORE THE HONORABLE RICARDO S. MARTINEZ
UNITED STATES DISTRICT COURT JUDGE

APPEARANCES:

For the Petitioner: James Weaver
Jeremy Hendon
Amy Matchison
U.S. DEPARTMENT OF JUSTICE

For the Respondent: Philip Beck
Brian Prestes
Robert Tannenbaum
Sean Gallagher
BARTLIT BECK HERMAN PALENCHAR &
SCOTT
Patricia Eakes
Andrea Ostrovsky
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09:33:49AM 1 THE CLERK: We are here for an evidentiary hearing
09:33:51AM 2 in the matter of the United States versus Microsoft
09:33:54AM 3 Corporation, Case No. C15-102, assigned to this court, and
09:33:59AM 4 United States versus Craig J. Mundie, et al., Case
09:34:05AM 5 No. C15-103, assigned to this court.

09:34:07AM 6 Counsel, please rise and make your appearance for the
09:34:10AM 7 record.

09:34:10AM 8 MR. WEAVER: James Weaver on behalf of the United
09:34:12AM 9 States. With me are Jeremy Hendon and Amy Matchison.

09:34:17AM 10 THE COURT: Good morning.

09:34:19AM 11 MR. BECK: Philip Beck on behalf of Microsoft.

09:34:21AM 12 MS. EAKES: Patty Eakes on behalf of Microsoft.

09:34:24AM 13 MS. OSTROVSKY: Andrea Ostrovsky on behalf of
09:34:28AM 14 Microsoft, your Honor.

09:34:28AM 15 MR. PRESTES: Brian Prestes on behalf of
09:34:30AM 16 Microsoft.

09:34:32AM 17 MR. GALLAGHER: Sean Gallagher on behalf of
09:34:34AM 18 Microsoft.

09:34:35AM 19 MR. TANNENBAUM: Robert Tannenbaum on behalf of
09:34:37AM 20 Microsoft.

09:34:38AM 21 THE COURT: Good morning to all of you. Thank
09:34:40AM 22 you.

09:34:44AM 23 Counsel, we have basically a day for our evidentiary
09:34:50AM 24 hearing that we have scheduled. The court has other
09:34:52AM 25 matters tomorrow, so we need to be able to get it

09:34:55AM 1 concluded today.

09:34:56AM 2 Let me indicate for purposes of a lot of people that
09:35:00AM 3 are in the courtroom, that may not know exactly what the
09:35:03AM 4 purpose of what is going on in this particular hearing, it
09:35:06AM 5 is actually a quite narrow issue. In this matter -- this
09:35:14AM 6 is an enforcement matter brought by the IRS against
09:35:17AM 7 Microsoft. Whenever a taxpayer objects or neglects to
09:35:25AM 8 obey a designated summons, the IRS may bring an
09:35:28AM 9 enforcement action in United States District Court. That
09:35:32AM 10 is what has happened here.

09:35:33AM 11 In order to obtain the court's enforcement, the IRS
09:35:36AM 12 then has the burden of making the initial showing of its
09:35:39AM 13 good faith by establishing that the investigation that it
09:35:43AM 14 is doing, or has done, will be conducted pursuant to a
09:35:47AM 15 legitimate purpose, that the inquiry may be relevant to
09:35:50AM 16 that purpose, that the information sought is not already
09:35:53AM 17 within the possession of the IRS, and that the
09:35:56AM 18 administrative steps required by the Internal Revenue Code
09:35:59AM 19 have been followed. In this case the court has already
09:36:02AM 20 made the finding that the IRS has made that prima facie
09:36:06AM 21 showing.

09:36:07AM 22 Once that occurs, once the IRS makes its initial
09:36:10AM 23 showing, then the burden shifts to the taxpayer, in this
09:36:13AM 24 case Microsoft, to demonstrate that enforcement of that
09:36:16AM 25 summons would result in an abuse of the court's process.

09:36:21AM 1 This adversarial enforcement proceeding exists to
09:36:25AM 2 protect against abuse of the power vested in tax
09:36:28AM 3 collectors. At the same time, enforcement proceedings are
09:36:31AM 4 to be summary in nature; the court is to avoid any broader
09:36:37AM 5 role than simply determining whether or not the IRS issued
09:36:40AM 6 a contested summons in good faith and without an improper
09:36:44AM 7 purpose.

09:36:45AM 8 The Supreme Court has held that a taxpayer is entitled
09:36:48AM 9 to a pre-enforcement evidentiary hearing upon making a
09:36:52AM 10 sufficient threshold showing of a defense or possible
09:36:55AM 11 defense for enforcement. This showing requires the
09:36:58AM 12 taxpayer to point to specific facts or circumstances
09:37:02AM 13 plausibly raising an inference of bad faith or of another
09:37:06AM 14 appropriate ground in order to quash the summons. Naked
09:37:11AM 15 allegations of improper purpose are simply not enough.
09:37:14AM 16 The taxpayer must offer some credible evidence supporting
09:37:19AM 17 their charge.

09:37:20AM 18 Use of circumstantial evidence is sufficient to make a
09:37:23AM 19 threshold showing. Discovery is then warranted if the
09:37:27AM 20 taxpayer, through the hearing, can make a substantial
09:37:30AM 21 preliminary showing of abuse, of wrongdoing. That's the
09:37:35AM 22 purpose of what we are here to do today.

09:37:38AM 23 My understanding, from looking at the materials
09:37:39AM 24 submitted by both sides, is that there is one live witness
09:37:44AM 25 apparently that will be called. There may be other

witnesses, depending on what happens. But I also understand that Microsoft is relying on the declarations of several other witnesses. The court understands that.

Are we ready? Since the burden is on Microsoft, I am not sure who is going to be starting. Ms. Eakes.

MR. WEAVER: Your Honor, could I raise one preliminary matter?

THE COURT: Mr. Weaver.

MR. WEAVER: Microsoft has identified as potential witnesses two attorneys, Daniel Rosen and James O'Brien. If they are going to possibly call them in rebuttal to our witness, Mr. Hoory, we would ask that the court exclude and sequester those witnesses.

MR. BECK: We are not going to be calling them, your Honor, especially given our need to finish today.

THE COURT: All right. Ms. Eakes.

MS. EAKES: Thank you. Good morning, your Honor. As the court has just stated, Microsoft is here today to ask the court to order discovery so that there will be a complete factual record before the court ultimately decides whether enforcing the designated subpoenas or summonses would result in an abuse of this court's process.

Now, as the court knows, this case is unusual in that it raises a couple of important issues to larger issues of

09:39:04AM 1 tax administration. It raises issues about whether or not
09:39:08AM 2 the IRS can or cannot use outside lawyers to perform audit
09:39:12AM 3 tasks, to take summon testimony, and to examine taxpayer
09:39:17AM 4 books and records, which are tasks that have historically
09:39:19AM 5 been reserved to the province of government officers and
09:39:24AM 6 employees. And it raises issues about whether the
09:39:26AM 7 temporary regulation that the IRS enacted weeks after
09:39:29AM 8 retaining Quinn Emanuel, and that purport to allow
09:39:32AM 9 government lawyers -- the non-government lawyers to take
09:39:35AM 10 summon testimony is valid. Those are the questions that
09:39:38AM 11 the court must ultimately reach.

09:39:40AM 12 But as the court just pointed out, that is not the
09:39:42AM 13 issue today. The issue today is simply whether or not
09:39:45AM 14 Microsoft has made a substantial preliminary showing the
09:39:49AM 15 enforcement of the subpoenas -- or the summonses would
09:39:51AM 16 abuse this court's process. We think we are going to make
09:39:54AM 17 that showing today, and as a result we are going to ask
09:39:56AM 18 the court to order some very limited and targeted
09:39:59AM 19 discovery, with the goal being to create a full record.

09:40:03AM 20 Microsoft is expecting today that we are going to
09:40:06AM 21 present evidence on four different issues: First of all,
09:40:09AM 22 the role that Quinn Emanuel has played in the audit to
09:40:12AM 23 date, the role that Quinn Emanuel will be playing going
09:40:16AM 24 forward in the audit. We are going to present evidence
09:40:19AM 25 that the procedures used by the IRS to enact the temporary

09:40:23AM 1 regulation are inconsistent with recent decision-making
09:40:27AM 2 and the other requirements of the APA. We are going to
09:40:31AM 3 present evidence that raises questions and concerns about
09:40:33AM 4 the administrative record that has been put forward by the
09:40:36AM 5 IRS in this case, and that go to its completeness and its
09:40:41AM 6 accuracy. We think it will require there be additional
09:40:44AM 7 discovery in order to determine what exactly the
09:40:48AM 8 administrative record should be.

09:40:49AM 9 As the court pointed out, we have already made the
09:40:52AM 10 preliminary showing. I am not going to cover what we have
09:40:56AM 11 already presented to the court, because it sounds like the
09:40:58AM 12 court has reviewed that and is aware of where we already
09:41:02AM 13 stand today. So let me talk about what we are going to
09:41:04AM 14 put on today or what we expect to put on today.

09:41:06AM 15 First of all, I want to start with the timeline so the
09:41:12AM 16 court kind of understands the key events. And I do have
09:41:15AM 17 copies of this PowerPoint for the court if you would like
09:41:18AM 18 to have one, a hard copy, or I can provide it to the court
09:41:21AM 19 after we are done.

09:41:23AM 20 First of all, the audit in this case began back in
09:41:27AM 21 January of 2007. It is an audit of the 2004/2006 tax
09:41:31AM 22 years. Now, Microsoft was engaging with the IRS from 2007
09:41:36AM 23 all the way forward into 2014.

09:41:39AM 24 And it appeared that the audit was winding down
09:41:43AM 25 towards the end of 2013. In fact, you will hear that in

09:41:48AM 1 January of 2014 the IRS met with Microsoft and they
09:41:52AM 2 presented their position on the Americas cost-sharing
09:41:55AM 3 arrangement. Now, that date is not on the timeline, but
09:41:58AM 4 you will hear testimony about that.

09:42:00AM 5 Ordinarily after that meeting it would have been the
09:42:03AM 6 end of the audit. And that's what Microsoft anticipated,
09:42:07AM 7 was that the audit was winding up after they received the
09:42:11AM 8 presentation from the IRS. But what Microsoft didn't know
09:42:14AM 9 is that the IRS had an entirely different plan that they
09:42:20AM 10 didn't disclose to Microsoft.

09:42:21AM 11 In fact, we know from the government's timeline that
09:42:24AM 12 starting back in November of 2013 the IRS had engaged with
09:42:30AM 13 Quinn Emanuel, a private outside law firm, with a plan to
09:42:34AM 14 involve them in the audit, and eventually to take the
09:42:37AM 15 underlying tax case to trial.

09:42:39AM 16 They didn't disclose that fact to Microsoft, and in
09:42:42AM 17 fact, through the first half of 2014, the IRS continued to
09:42:47AM 18 engage with Microsoft about the audit, all the while they
09:42:51AM 19 were meeting with Quinn Emanuel. They were having
09:42:53AM 20 settlement talks with Microsoft, but not advising them
09:42:57AM 21 about Quinn Emanuel being in the wings. And they entered
09:43:00AM 22 into a contract with Quinn Emanuel. Again, Microsoft
09:43:03AM 23 didn't know anything about it.

09:43:05AM 24 The IRS also did not disclose that to Microsoft at the
09:43:09AM 25 time in February of 2014, when they asked Microsoft to

09:43:15AM 1 extend the statute of limitations for the audit, which at
09:43:18AM 2 that time was set to expire in June of 2014. So Microsoft
09:43:21AM 3 agreed to that extension, having no knowledge of the fact
09:43:25AM 4 that Quinn Emanuel was being engaged, or had already been,
09:43:29AM 5 or was on the verge of being hired.

09:43:31AM 6 Microsoft also later learned that simultaneously --
09:43:35AM 7 and, again, they didn't know any of this was happening --
09:43:38AM 8 that the IRS was putting together and enacting a temporary
09:43:41AM 9 regulation that they planned to point to to say that Quinn
09:43:45AM 10 Emanuel could examine Microsoft's books and records and
09:43:48AM 11 take summon testimony pursuant to the designated
09:43:51AM 12 summonses.

09:43:52AM 13 It wasn't until late August, and specifically
09:43:57AM 14 August 28th, 2014, that the IRS finally disclosed the fact
09:44:01AM 15 that they had hired Quinn Emanuel, and that they intended
09:44:04AM 16 to have them present at the upcoming interviews of
09:44:07AM 17 Microsoft employees that were scheduled for September of
09:44:09AM 18 that same year.

09:44:11AM 19 Now, even after that disclosure, the IRS continued to
09:44:16AM 20 hide the ball from Microsoft about what exactly was going
09:44:19AM 21 on. When Microsoft got notice about Quinn Emanuel they
09:44:22AM 22 asked the IRS, "Hey, give us a copy of your engagement
09:44:26AM 23 letter." The testimony is going to show that Mr. Hoory
09:44:30AM 24 said, "We don't have an engagement letter with Quinn
09:44:33AM 25 Emanuel." So Microsoft went, did their own research,

09:44:37AM 1 found that in fact on a government database there was a
09:44:40AM 2 contract between Quinn Emanuel and the IRS. So they wrote
09:44:42AM 3 to the IRS and said, "Give us a copy of the contract, if
09:44:45AM 4 you don't call it an engagement letter." The IRS said,
09:44:48AM 5 "Well, okay, there is a contract, and here we are sending
09:44:51AM 6 you the full contract."

09:44:52AM 7 The court is going to hear that in fact the IRS only
09:44:55AM 8 sent a portion of that contract to Microsoft. The portion
09:45:00AM 9 they chose to withhold from Microsoft was the part that
09:45:03AM 10 showed that in fact they had engaged Quinn Emanuel for the
09:45:06AM 11 purpose of eventually litigating the tax case, among other
09:45:10AM 12 things.

09:45:10AM 13 Let me just talk for a moment about the hiring of
09:45:17AM 14 Quinn Emanuel. The court is going to hear that the IRS
09:45:23AM 15 engaged Quinn Emanuel as contractors, not as government
09:45:27AM 16 employees. As contractors, Quinn Emanuel was not bound by
09:45:32AM 17 the conflict and ethics rules that are applicable to
09:45:35AM 18 Treasury Department lawyers. This is a significant issue,
09:45:38AM 19 and it is not one that just Microsoft was concerned about.

09:45:42AM 20 When the Senate Finance Committee realized that the
09:45:46AM 21 IRS had outsourced an audit to private lawyers, Senator
09:45:51AM 22 Orrin Hatch wrote a letter to the IRS. This is a copy of
09:45:54AM 23 the letter on PowerPoint now. He pointed out, "Unlike
09:45:58AM 24 private contractors, Treasury Department officials are
09:46:00AM 25 required to swear an oath to the Constitution and are

09:46:03AM 1 subject to rules of conduct and federal law regulating
09:46:05AM 2 their interactions with taxpayers." He went on to say,
09:46:08AM 3 "This is one of the core reasons Congress has sought to
09:46:10AM 4 limit certain examination actions to these officials, who
09:46:14AM 5 are accountable to the public, and for whom there is a
09:46:17AM 6 clear chain of command." And he expressed concern about
09:46:21AM 7 "turning over inherently governmental functions, such as
09:46:24AM 8 conducting an examination, to private contractors, because
09:46:28AM 9 it doesn't protect the rights of taxpayers."

09:46:33AM 10 Now, the concerns about Quinn Emanuel and using a
09:46:36AM 11 private law firm like Quinn Emanuel in this case, in the
09:46:39AM 12 Microsoft audit, were very real. As the court is going to
09:46:42AM 13 hear, there are a number of conflicts that Quinn Emanuel
09:46:44AM 14 had and that existed at the time the IRS chose to disclose
09:46:48AM 15 confidential taxpayer -- Microsoft's confidential taxpayer
09:46:52AM 16 information to Quinn Emanuel without ever giving Microsoft
09:46:56AM 17 any advance notice to have an opportunity to protect their
09:46:59AM 18 rights.

09:46:59AM 19 The court is going to hear testimony that Quinn
09:47:02AM 20 Emanuel is the primary outside counsel to Google, and that
09:47:05AM 21 Google is one of Microsoft's largest competitors. In
09:47:09AM 22 fact, at the time -- after Microsoft was aware of the
09:47:16AM 23 hiring of Quinn Emanuel they provided to the IRS a list of
09:47:21AM 24 cases that they had actively against Microsoft at that
09:47:25AM 25 time. And there were 34 cases that Quinn Emanuel was

09:47:29AM 1 handling that were directly adverse to Microsoft. And
09:47:34AM 2 they knew that at the time -- or they had these cases at
09:47:37AM 3 the time the IRS was disclosing behind Microsoft's back
09:47:40AM 4 the confidential taxpayer information.

09:47:42AM 5 Now, let me just shift for a minute and tell the court
09:47:48AM 6 what we expect the evidence is going to show with respect
09:47:51AM 7 to Quinn Emanuel and their role that they had been playing
09:47:54AM 8 in this audit. The evidence is going to show that Quinn
09:47:58AM 9 Emanuel told the IRS what records it wanted, and the IRS
09:48:01AM 10 asked Microsoft to produce them. Quinn told the IRS who
09:48:07AM 11 they wanted to question and on what topics, and the IRS
09:48:09AM 12 asked Microsoft to make those employees available. Quinn
09:48:13AM 13 identified who they wanted to have questioned under oath
09:48:15AM 14 pursuant to the designated summonses, and the IRS issued
09:48:18AM 15 those summonses. Quinn was also involved and participated
09:48:24AM 16 in deciding the content of the designated summonses that
09:48:26AM 17 are before this court. We also know that the IRS has said
09:48:32AM 18 definitively that if the court enforces these summonses,
09:48:35AM 19 it intends to have Quinn Emanuel do some of the
09:48:38AM 20 questioning of the Microsoft witnesses.

09:48:41AM 21 And even though the IRS has told this court, "Well,
09:48:46AM 22 Quinn Emanuel isn't engaging in any inherently
09:48:49AM 23 governmental functions," in fact, the contract shows that
09:48:54AM 24 in fact the performance of the work involves exactly what
09:48:58AM 25 the temporary regulation says is an inherently

09:49:03AM 1 governmental functions.

09:49:05AM 2 So the Federal Register -- the provision provides that
09:49:09AM 3 one of the things that is inherently governmental function
09:49:12AM 4 is identifying what information must be produced. And the
09:49:15AM 5 Quinn Emanuel contract shows that is exactly what the IRS
09:49:19AM 6 has asked Quinn Emanuel to do.

09:49:21AM 7 Talking about the temporary regulation now. Microsoft
09:49:30AM 8 expects that the evidence is going to show that the IRS
09:49:33AM 9 enacted the temporary regulation, at least in part,
09:49:36AM 10 because of the Microsoft audit. The Microsoft audit is
09:49:40AM 11 being overseen by what is called the LB&I section of the
09:49:45AM 12 IRS, which is the large business and international group.
09:49:47AM 13 The court is going to see evidence that in fact it was the
09:49:51AM 14 LB&I that was the impetus and who initiated the temporary
09:49:55AM 15 regulation.

09:49:58AM 16 You are also going to hear that Mr. Hoory, who is
09:50:01AM 17 going to testify today, is directly overseeing the
09:50:03AM 18 Microsoft audit, and he was aware of the temporary
09:50:06AM 19 regulation, and he weighed in on the wording of the
09:50:10AM 20 temporary regulation and other issues prior to its
09:50:13AM 21 enactment.

09:50:18AM 22 Also, the IRS, in explaining why they needed this to
09:50:22AM 23 be an emergency publication, cited that it was the running
09:50:24AM 24 of the statute of limitations that was the reason they had
09:50:27AM 25 to push this through without the ordinary notice, and

comment, and time for publication, which only makes sense in the context of a particular case or cases, because the statute of limitations are expiring all the time on audits.

And the court will hear testimony that in fact the Microsoft statute of limitations, the audit, was set -- the statute of limitations was set to expire within six months of the enactment of this temporary regulation.

We are also going to present evidence that the temporary regulation -- the big push by the IRS to get this temporary regulation out began on the exact day that Microsoft told the IRS that they were no longer going to engage in settlement negotiations. So you can see here -- this is the declaration of Mr. Bernard, who says that on March 27th they advised the IRS they were ceasing all settlement discussions. On the same day the people at the IRS said we have to get this temporary regulation out by June 1.

You are also going to hear evidence from the administrative file, and I believe from Mr. Hoory, that the IRS anticipated all along that this temporary regulation is going to be used by outside lawyers to perform the questioning and to examine books and records. As you can see, these are just some examples of the documents that are in the administrative file, which the

09:51:56AM 1 court will have, which show that the intent all along was
09:51:59AM 2 to involve private lawyers.

09:52:01AM 3 The court will also hear that the Microsoft audit was
09:52:04AM 4 the only case in which private lawyers had been engaged.
09:52:09AM 5 So you see in the temporary -- you see in the
09:52:12AM 6 administrative file that the IRS is fully anticipating
09:52:14AM 7 having lawyers involved, even though the regulation
09:52:16AM 8 doesn't say that. And yet Microsoft is the only case
09:52:19AM 9 where we are going to have private lawyers involved in an
09:52:21AM 10 audit.

09:52:23AM 11 There is also going to be evidence that we will
09:52:29AM 12 present today to show that the IRS wasn't transparent with
09:52:32AM 13 the internal stakeholders at the IRS, the Department of
09:52:37AM 14 Treasury, and OMB, about how they intended for this
09:52:40AM 15 temporary regulation to be used.

09:52:42AM 16 The administrative record is full of examples about
09:52:45AM 17 how the IRS drafters of this regulation appeared to be
09:52:50AM 18 trying to hide the ball from those people within the
09:52:53AM 19 agency about exactly what they intended, and that they
09:52:55AM 20 intended to bring private lawyers into the Microsoft
09:52:59AM 21 audit. I will only show you two examples of those things
09:53:01AM 22 today, but the file consists of more.

09:53:04AM 23 So the internal communications at the IRS about this
09:53:08AM 24 temporary regulation -- again, it was fully intended to
09:53:12AM 25 have lawyers be involved -- told people within the IRS

09:53:15AM 1 that they were implementing the regulation so that people
09:53:18AM 2 such as outside economists, engineers, or consultants
09:53:22AM 3 could participate in the summons interview. There is not
09:53:26AM 4 one word in the internal documents within the IRS that
09:53:29AM 5 says -- tells people within the agency that they intend to
09:53:33AM 6 use this to have lawyers do the questioning -- outside
09:53:37AM 7 lawyers do the questioning in an audit.

09:53:39AM 8 You are also going to hear that despite the fact that
09:53:43AM 9 there were clear policies within the IRS and the IRM
09:53:47AM 10 manual that require early circulation to internal
09:53:51AM 11 stakeholders of the regulation to give them time for
09:53:54AM 12 consideration of it and to provide feedback, that the
09:53:57AM 13 people behind this regulation only gave five days for
09:54:01AM 14 feedback from the internal people before rushing it into
09:54:05AM 15 publication. That is on top of the fact that they weren't
09:54:08AM 16 explicitly telling people within the IRS that this
09:54:11AM 17 regulation is intended to be used by lawyers, that we
09:54:14AM 18 intend to have lawyers involved in audits.

09:54:17AM 19 The court is also going to hear testimony that the IRS
09:54:21AM 20 wasn't transparent with the public about the true purpose
09:54:24AM 21 of the regulation. Now, the IRS, as the court knows,
09:54:29AM 22 issued this as a temporary regulation, which meant that it
09:54:32AM 23 went into effect immediately, and didn't allow for any
09:54:34AM 24 sort of notice and comment period by the public.

09:54:38AM 25 The IRS has typically let the public know about the

fact that they intend to pass guidance by putting out what is called the business plan. The business plan is a public document that says here is everything that we are expecting to issue guidance on in the upcoming future.

This regulation, the 7602 regulation, wasn't on the business plan. And in fact, it only appeared on the business plan after the court granted this hearing, and after Microsoft disclosed in its exhibits, when we thought the hearing was happening in July, that there were business plans where this regulation was absent. After all of that happened, suddenly this regulation that the IRS had been considering working on since sometime in 2013 appeared on the business plan.

And, finally, the other way that the IRS concealed from the public what the true purpose of this regulation was, was in the wording itself of the regulation. So what was published in the Federal Register, which included the published explanation of the regulation itself, refers only to contractors throughout the regulation, and never once says anything about lawyers, even though that was clearly the purpose that the IRS had in mind in passing this regulation.

Now, I want to talk for just a moment about the administrative record and the concerns that Microsoft has about the administrative record. I just want to briefly

09:56:05AM 1 kind of recap why we are talking about the administrative
09:56:08AM 2 record here today. When the court granted the evidentiary
09:56:11AM 3 hearing, you found that there were factual questions that
09:56:15AM 4 went to the validity of the temporary regulation. And the
09:56:17AM 5 IRS initially said they were going to bring one or even
09:56:21AM 6 more than one witness to testify about why the temporary
09:56:24AM 7 regulation was enacted.

09:56:26AM 8 As you will recall, at that time Microsoft asked the
09:56:29AM 9 court for -- to have the IRS produce Heather Maloy, who
09:56:33AM 10 authorized the temporary regulation, so she could testify
09:56:36AM 11 on the issues that the court had identified. And the
09:56:39AM 12 court deferred that request from Microsoft on the
09:56:41AM 13 representation that the IRS intended to call a witness who
09:56:44AM 14 had knowledge about the temporary regulation and its
09:56:48AM 15 enactment.

09:56:48AM 16 So then following that telephonic hearing the IRS
09:56:52AM 17 disclosed that they intended to call somebody by the name
09:56:55AM 18 of Tom Vidano. The IRS then said they wouldn't call
09:57:00AM 19 Mr. Vidano unless Microsoft would agree up front there
09:57:03AM 20 would be no waiver of any known privileges before we ever
09:57:07AM 21 heard anything about his testimony. And Microsoft simply
09:57:10AM 22 couldn't agree to that. And so the IRS withdrew
09:57:14AM 23 Mr. Vidano.

09:57:16AM 24 Even though Mr. Hoory has some knowledge about this
09:57:18AM 25 temporary regulation, the IRS is now taking the position

09:57:21AM 1 that the court should only look at what they claim to be
09:57:24AM 2 the administrative record in deciding if the regulation
09:57:26AM 3 was valid.

09:57:27AM 4 And even assuming that is correct for the sake of this
09:57:30AM 5 argument, there are a number of things about the
09:57:34AM 6 administrative record that has been put forward by the IRS
09:57:36AM 7 that causes concern about whether it is complete, and how
09:57:40AM 8 it was put together, and whether or not the court should
09:57:42AM 9 give it the presumption of regularity that would
09:57:45AM 10 ordinarily apply.

09:57:46AM 11 So I am just going to cover those quickly, what the
09:57:50AM 12 issues are in the administrative record. First of all,
09:57:52AM 13 the case law is clear that the administrative record is
09:57:55AM 14 supposed to contain only what was considered at the time
09:57:58AM 15 prior to the enactment of the temporary regulation, what
09:58:03AM 16 the agency considered.

09:58:07AM 17 Here, the file contains a number of different
09:58:09AM 18 documents that were clearly printed out sometime after the
09:58:13AM 19 regulation went into effect. So these are just a sample
09:58:18AM 20 of the documents that show -- this was back in July
09:58:22AM 21 of 2015 -- this file was filled with things that were
09:58:23AM 22 printed out at that time.

09:58:27AM 23 Now, initially the IRS, when they first disclosed the
09:58:30AM 24 administrative record, didn't say anything about it. They
09:58:32AM 25 subsequently offered a declaration amending it, and

09:58:35AM 1 saying, "Well, these might have a print date of July 2015,
09:58:38AM 2 but they were considered at the time."

09:58:39AM 3 But the IRS hasn't offered any sort of explanation to
09:58:42AM 4 the court -- there is nothing in the file to show that
09:58:44AM 5 these things were in fact considered by the agency at the
09:58:47AM 6 time. There is simply no way for the court to evaluate
09:58:50AM 7 whether or not that representation is accurate.

09:58:52AM 8 Another concern with the administrative record is that
09:58:56AM 9 it has changed. Initially the administrative record was
09:59:00AM 10 disclosed to Microsoft on July 13th. And in the first
09:59:04AM 11 administrative record that we received it included this
09:59:07AM 12 document, Microsoft Exhibit 135. And this was what
09:59:12AM 13 appeared to be a one-page email related to statistics that
09:59:17AM 14 LB&I was providing to support why the temporary regulation
09:59:20AM 15 was necessary. But then on July 17th, four days later,
09:59:26AM 16 DOJ -- IRS provided an updated administrative record, and
09:59:31AM 17 all of a sudden this one-page document was four pages.
09:59:35AM 18 And there was no explanation.

09:59:36AM 19 And it is concerning, because there was no reason to
09:59:42AM 20 believe that the one-page document was anything more than
09:59:44AM 21 a one-page document. There wasn't a privilege log. There
09:59:46AM 22 weren't any redactions. There was simply no explanation
09:59:50AM 23 other than to think it was a one-page document, that four
09:59:53AM 24 days later morphs into a four-page document, without any
09:59:56AM 25 sort of explanation. I think it raises concerns about

whether or not there are things that are missing from the administrative record when it is produced in that fashion.

And we do know that there are missing records from the administrative record that the IRS put forward. As the court may recall, Microsoft has made FOIA requests to the IRS related to the temporary regulation. And one of the things that we asked for were all documents related to the regulatory history of the temporary regulation. Microsoft expected that would yield basically the records that would later become the administrative record, that were part of the administrative record.

Well, in the FOIA case, in response to that request, Microsoft received over 1,400 pages of documents in response to that request. But the administrative record that was produced by the IRS is only 630 pages. There is just no explanation for that discrepancy.

We can also see from looking at the file itself that there are things that are missing. This email, which is part of the administrative record that they submitted to the court, refers to the fact that there is a representative contract that is being considered by the drafters of this regulation. Clearly it is something that was considered by the agency, and yet the attachment isn't in the administrative record.

Well, we know that it exists, because in the FOIA

10:01:24AM 1 action this is what we received, which is the same email,
10:01:28AM 2 with redactions, and an attachment that is fully redacted
10:01:32AM 3 out. So, again, something missing from the administrative
10:01:35AM 4 record that was clearly considered by the agency.

10:01:38AM 5 But even more importantly, last Friday the IRS
10:01:43AM 6 disclosed this document, which now tells the court that
10:01:48AM 7 the IRS -- the drafters of the regulation considered
10:01:52AM 8 precisely the issue that is before this court, and that is
10:01:56AM 9 whether or not contractors can be treated as IRS employees
10:01:59AM 10 for purposes of 7602.

10:02:02AM 11 Now, we received only this email. We didn't receive
10:02:07AM 12 the memo. But what is concerning, and what should concern
10:02:10AM 13 the court, is that neither this email, nor the memo, are
10:02:14AM 14 part of what has been submitted to you as the purported
10:02:17AM 15 administrative record. So there are a lot of questions
10:02:20AM 16 about what is or isn't in the administrative record, and
10:02:23AM 17 why there is the disconnect between that and the FOIA.

10:02:28AM 18 There is also redaction issues that we think should
10:02:31AM 19 concern the court. I am just giving you one example of
10:02:35AM 20 that here. In the summons enforcement case we received
10:02:39AM 21 this document. That's the executive summary for the
10:02:41AM 22 summons interview regulation. And yet in the FOIA case,
10:02:45AM 23 we received it completely redacted on the claim of
10:02:50AM 24 deliberative process.

10:02:54AM 25 Again, this just raises an issue, we think, about

10:02:55AM 1 whether there have been improper redactions for those
10:02:57AM 2 things that are actually in the administrative record, and
10:03:00AM 3 whether or not there are wholesale redactions that have
10:03:04AM 4 been done by the IRS, which is information of --
10:03:08AM 5 information that isn't properly privileged or should be
10:03:10AM 6 considered by this court.

10:03:11AM 7 So that's kind of a quick recap of what we expect the
10:03:17AM 8 evidence is going to show today. I want to take a minute,
10:03:21AM 9 though, and talk about what is not at issue in this
10:03:23AM 10 hearing today. Microsoft fully expects that the IRS is
10:03:28AM 11 going to try to use this evidentiary hearing to try to
10:03:31AM 12 embarrass Microsoft, to portray the company as a tax
10:03:36AM 13 evader, and to improperly disclose our confidential
10:03:40AM 14 taxpayer information, information that would be
10:03:43AM 15 confidential in an audit, and, but for this hearing, would
10:03:46AM 16 not be disclosable to the public.

10:03:48AM 17 Now, the reason we are concerned is not only because
10:03:51AM 18 of the exhibits that have been identified by the IRS for
10:03:53AM 19 this hearing, which go to the underlying financials and
10:03:57AM 20 the issues that are within the audit, but the IRS has also
10:04:03AM 21 publicly stated they plan to basically punish taxpayers
10:04:06AM 22 who fight summons enforcement proceedings.

10:04:10AM 23 You will see in an article to the press -- this is in
10:04:14AM 24 January of 2015, so after Microsoft had let it be known
10:04:18AM 25 that the company intended to fight the summons enforcement

10:04:21AM 1 proceedings, a senior IRS lawyer told the press, "The
10:04:26AM 2 taxpayers and practitioners should be cautious when asking
10:04:29AM 3 for an evidentiary hearing to prove that a summons was
10:04:31AM 4 issued for an improper purpose." They warned that, "An
10:04:36AM 5 evidentiary hearing is a two-way street. It is not simply
10:04:38AM 6 the taxpayer's opportunity to question the agent." And,
10:04:43AM 7 "The taxpayer should think about whether they want to have
10:04:45AM 8 their officials being examined by the IRS in a public
10:04:48AM 9 courtroom, and whether they want to have a DOJ lawyer
10:04:51AM 10 talking about the underlying tax transactions that the IRS
10:04:54AM 11 is looking at."

10:04:56AM 12 That threat is exactly what Microsoft is concerned is
10:05:01AM 13 going to be attempted to be carried out today. We believe
10:05:04AM 14 the IRS is trying to punish Microsoft for successfully
10:05:07AM 15 getting this hearing by disclosing our confidential
10:05:11AM 16 taxpayer information, and sending a message to other
10:05:13AM 17 taxpayers not to do what Microsoft has done and gotten in
10:05:17AM 18 this case. I would urge the court not to permit the IRS
10:05:20AM 19 to do that. The financial information underlying the
10:05:22AM 20 audit, the positions that the parties have taken is simply
10:05:27AM 21 not relevant to any of the issues before the court today.

10:05:30AM 22 It is fundamentally unfair for the IRS to throw out
10:05:35AM 23 numbers, particularly when they are maintaining they
10:05:38AM 24 haven't actually made a conclusion as to what tax is due,
10:05:42AM 25 in a context where Microsoft can't call experts or dispute

1 or explain the numbers that are being thrown out and can
2 be misconstrued by people.

3 In short, we urge the court not to let the IRS misuse
4 this hearing, which is supposed to be about the IRS's
5 conduct, to publicize Microsoft's confidential
6 information.

7 In conclusion, Microsoft believes at the end of today
8 that we will show the court that there are troubling
9 questions here about the IRS's hiring of Quinn Emanuel and
10 their involvement in the Microsoft audit.

11 Microsoft, of course, has concerns about what the IRS
12 has done, but their concerns are also shared by Congress.
13 Both the House Ways and Means Committee, as well as the
14 Senate Finance Committee, share the concerns that
15 Microsoft has. We believe at the end of the presentation
16 today the court, too, will have even more questions and
17 concerns about what the IRS has done. At that time we
18 will ask the court to order some limited discovery so a
19 full record can be created before the court decides
20 whether or not to enforcement the summonses. Thank you.

21 THE COURT: Ms. Eakes, thank you very much.

22 Mr. Weaver, I don't know if you, the IRS, would like
23 to make any preliminary statements before we call the
24 first witness, or should we just get into the first
25 witness?

10:07:07AM 1 MR. WEAVER: Yes, your Honor, if we could.

10:07:27AM 2 Your Honor, the story of how Microsoft -- excuse me,
10:07:31AM 3 the story of how the IRS came to retain Quinn Emanuel
10:07:34AM 4 begins in 2011. In June of that year Microsoft submitted
10:07:38AM 5 to the IRS a document called a protest. In that protest
10:07:43AM 6 Microsoft took issue with certain adjustments that the IRS
10:07:46AM 7 had proposed making to Microsoft's tax returns for the
10:07:52AM 8 2004 through 2006 years, adjustments that would increase
10:07:55AM 9 Microsoft's taxable income by billions of dollars.

10:07:58AM 10 Now, those adjustments arise from two complex
10:08:01AM 11 international arrangements that we will call today the
10:08:05AM 12 Americas transaction and the Asia Pacific transaction.

10:08:09AM 13 In its protest Microsoft claimed that the analysis
10:08:13AM 14 underlying the IRS's notice of proposed adjustments was,
10:08:17AM 15 quote, arbitrary and capricious. And Microsoft argued
10:08:21AM 16 that the valuation method used by the IRS to figure out
10:08:25AM 17 and measure the income from these transactions was
10:08:28AM 18 improper. They complained that the IRS should have used a
10:08:32AM 19 different method, and taken a more granular look at the
10:08:36AM 20 transactions.

10:08:38AM 21 In support of its protest Microsoft relied heavily on
10:08:42AM 22 a tax court case called Veritas v. Commissioner, a 2009
10:08:47AM 23 case that did not turn out well for the IRS. In Veritas
10:08:51AM 24 the tax court found that expert testimony offered by the
10:08:54AM 25 IRS was unsupported and unreliable. The tax court

1 determined that the IRS notice of deficiency, the document
2 issued at the conclusion of an audit, was, quote,
3 arbitrary and capricious, because the analysis presented
4 at trial in Veritas was different than the analysis in the
5 exam phase of the case.

6 Now, Microsoft's protest is a long document. You will
7 see parts of that document today. The protest even
8 faulted the IRS for relying on, among other things, notes
9 of earlier interviews, interviews not under oath, and not
10 transcribed. Microsoft characterized such evidence as,
11 quote, of questionable utility.

12 Now, starting in late 2011, a relatively new component
13 of the IRS called Transfer Pricing Operations, or TPO for
14 short, began to coordinate aspects of the Microsoft audit
15 that we care about here today.

16 And there were several goals in mind for the audit:
17 One was to develop facts better; two was to resolve or
18 narrow differences, where possible; and three was to make
19 greater use of experts of various kinds.

20 Now, TPO withdrew the IRS notice of proposed
21 adjustment that had generated the protest; and TPO decided
22 to take a closer look at the transactions; and of
23 particular interest here, the method that Microsoft and
24 its advisor KPMG had used to value components of the
25 Americas transaction.

10:10:34AM 1 Mr. Hoory, who is here today, a senior advisor with
10:10:38AM 2 TPO, will testify about his understanding that as of July
10:10:42AM 3 2005, Microsoft effectively transferred certain rights and
10:10:46AM 4 software code, such as Windows, to an offshore affiliate
10:10:51AM 5 in Puerto Rico with respect to retail sales in America.
10:10:54AM 6 But Microsoft did not transfer other things, like the
10:10:58AM 7 right to use Microsoft's name, things that you need to
10:11:01AM 8 actually sell product, to the Puerto Rico affiliate. And
10:11:07AM 9 Microsoft's U.S. affiliates would still be doing the
10:11:10AM 10 selling.

10:11:11AM 11 Now, to better understand the KPMG valuation that
10:11:16AM 12 Microsoft was relying on and the assumptions, TPO engaged
10:11:21AM 13 experts in 2012, in software code, brand and marketing
10:11:27AM 14 valuation, as well as financial and industry experts. To
10:11:30AM 15 help pull these disparate areas together, and to develop a
10:11:35AM 16 persuasive and coherent framework, TPO decided to try
10:11:39AM 17 something new, obtaining the services of a commercial
10:11:42AM 18 litigator.

10:11:44AM 19 Mr. Hoory, and his boss, Mr. Maruca, reasoned that the
10:11:49AM 20 ultimate goals of the audit, getting to the right numbers
10:11:52AM 21 and supporting those numbers with solid factual and legal
10:11:54AM 22 support, would be well advanced by obtaining the advice
10:11:59AM 23 and assistance of someone with experience in developing
10:12:02AM 24 and evaluating large complex cases. And TPO reasoned that
10:12:07AM 25 a commercial litigator would also serve as a sounding

1 board to provide an independent analysis of the strengths
2 and the weaknesses of the audit.

3 And make no mistake, Microsoft's audit that we are
4 here today about is one of the largest and most
5 complicated audits ever undertaken by the IRS.

6 To be clear, if the case did not resolve at the exam
7 stage, and it went beyond that, then these attorneys might
8 also bring experience to the table were a trial to ensue.

9 Now, you will learn today that during the second half
10 of 2012, TPO first reached out to another law firm, the
11 law firm of Boies Schiller. Mr. Hoory hoped to obtain an
12 evaluation of the audit, of the strengths and weaknesses,
13 from the law firm before making a presentation to
14 Microsoft to try and resolve and narrow their differences.
15 Unfortunately, nothing was ever done on that contract
16 because of conflicts of interest.

17 Mr. Hoory first contacted a representative from Quinn
18 Emanuel in late 2013.

19 Now, to address one of the concerns in your Honor's
20 order, Mr. Hoory made no mention of Microsoft before a
21 proper nondisclosure agreement was in place.

22 The first meeting with Quinn Emanuel took place in
23 late February 2014. And the purpose of that meeting was
24 to ascertain if the firm would be a good fit for the
25 anticipated tasks at hand, the provision of legal advice

10:13:54AM 1 regarding the strengths and weaknesses of the case, and
10:13:57AM 2 assistance in developing facts and legal theories during
10:14:00AM 3 the remainder of the exam.

10:14:03AM 4 After that initial meeting in February, the next
10:14:07AM 5 substantive communications between Mr. Hoory and Quinn
10:14:10AM 6 Emanuel did not occur until July 15, 2014.

10:14:16AM 7 Now, during the intervening months between February
10:14:19AM 8 and July, for reasons having nothing to do at all with
10:14:23AM 9 Quinn Emanuel, resolution discussions with Microsoft,
10:14:27AM 10 discussions that Mr. Hoory had tried to get started
10:14:30AM 11 through a presentation in January of 2014, came to a halt.

10:14:36AM 12 Contrary to allegations, Mr. Hoory will confirm that
10:14:39AM 13 he received no input whatsoever from Quinn Emanuel
10:14:43AM 14 regarding the information document requests, the IDRs,
10:14:48AM 15 served on Microsoft in July of 2014.

10:14:53AM 16 And you will learn from Mr. Hoory, far from
10:14:55AM 17 outsourcing the audit, as has been suggested by Microsoft,
10:14:58AM 18 the direction of the audit, the subject matter of the
10:15:02AM 19 IDRs, the subject matters of the interviews that occurred
10:15:05AM 20 in the fall of 2014, and even the necessary follow-up in
10:15:09AM 21 the summonses that are pending here, these lines of
10:15:13AM 22 inquiry and the subject matters addressed were largely
10:15:17AM 23 determined before Quinn Emanuel read a single audit
10:15:21AM 24 document and provided any advice.

10:15:23AM 25 Now, what has become increasingly clear to Mr. Hoory

1 is that some of the assumptions underlying the KPMG
2 valuation study relied on by Microsoft are highly
3 questionable. And I will get to that in a minute.

4 But what about allegations that Quinn Emanuel
5 attorneys performed inherently governmental functions?
6 Not so, your Honor. We will look today at Quinn Emanuel's
7 contract, and we will look at the prohibition in that
8 contract against performing inherently governmental
9 functions. That section of the contract refers to an OPM
10 policy letter that sets out what is and what is not
11 inherently governmental. Fact gathering is not inherently
12 governmental. Providing legal advice is not inherently --
13 an inherently governmental function.

14 Now, appearing before a tribunal is an inherently
15 governmental function, but Quinn Emanuel did not do that.

16 Well, what about inspecting books and records or
17 asking questions, two concerns raised in your Honor's
18 order? If we could put up the one slide I want to use
19 here, which is this slide here. I have put up Section A
20 of the summons statute, your Honor, 7602. And what you
21 will see -- I have highlighted -- the highlights are
22 mine, the words "authority to summon." And then down
23 below you will see "secretary is authorized."

24 Now, what this statute is doing, your Honor, is
25 cloaking the secretary with authority to do the things

10:16:57AM 1 listed below, to examine books and records, to summon
10:17:02AM 2 someone to appear before the IRS, to take testimony. The
10:17:09AM 3 secretary can demand that that occur. But no one -- no
10:17:11AM 4 one except Microsoft, in its briefing, construes Part
10:17:14AM 5 (a)(1) of this statute here as prohibiting an outside
10:17:20AM 6 expert, properly retained under 6103(n), from assisting
10:17:25AM 7 the IRS in review of books and records. In fact, it is
10:17:28AM 8 the necessary practice of the IRS to ask outside experts,
10:17:32AM 9 be they financial, economic, scientific, technical, or
10:17:36AM 10 even sometimes legal experts, to review taxpayer books and
10:17:41AM 11 records.

10:17:42AM 12 Were you to bar experts, under contract properly, from
10:17:49AM 13 looking at books and records obtained through summonses,
10:17:51AM 14 you would effectively shut down virtually all complex
10:17:55AM 15 audits in the IRS. That certainly can't be the proper way
10:17:58AM 16 to interpret the statute.

10:17:59AM 17 Now, your Honor, if the phrase "examine books and
10:18:03AM 18 records" is about who is cloaked with the authority to
10:18:06AM 19 invoke these three things, but is silent on the procedure,
10:18:10AM 20 so too then the phrase in Part 3, "to take such
10:18:14AM 21 testimony," is about who has the authority to require the
10:18:18AM 22 interview, not the procedures of where, or how, or who may
10:18:23AM 23 attend, or even who may speak.

10:18:26AM 24 What about the regulation? You will hear today that
10:18:32AM 25 the regulation -- the temporary regulation allowing

10:18:35AM 1 contractors to fully participate in interviews, which
10:18:40AM 2 Microsoft claims was rushed through hastily for the Quinn
10:18:45AM 3 Emanuel contract, actually arose out of earlier concerns
10:18:48AM 4 in 2013 related to another audit.

10:18:52AM 5 Now, once in the pipeline, of course TPO wanted to get
10:18:56AM 6 the regulation up and running as soon as possible. TPO
10:19:00AM 7 had been using experts to attend interviews and advise the
10:19:04AM 8 IRS, and, where appropriate, interpose questions. But
10:19:08AM 9 there is no improper motive for this regulation. It
10:19:11AM 10 didn't even start with Microsoft.

10:19:15AM 11 What about the summonses? The summonses -- the
10:19:20AM 12 summons requests here flow from Microsoft's failure to
10:19:23AM 13 adequately respond to earlier IRS requests. Only in late
10:19:29AM 14 2014 and 2015, after the summonses were issued, has the
10:19:36AM 15 IRS received details from Microsoft about certain
10:19:39AM 16 financial projections that it has been asking for for some
10:19:42AM 17 time, some of which Microsoft's tax department had
10:19:45AM 18 previously stated either didn't exist or couldn't be
10:19:47AM 19 found.

10:19:48AM 20 It is only after the summonses were issued, your
10:19:51AM 21 Honor, in 2014, that it has become increasingly clear just
10:19:56AM 22 how involved KPMG was, not in just valuing the Americas
10:20:02AM 23 transaction, but in helping Microsoft engineer a
10:20:06AM 24 tax-driven result. Mr. Hoory now has concerns about the
10:20:09AM 25 independence of KPMG's analysis.

10:20:13AM 1 You will see, we will present evidence today, where
10:20:15AM 2 internal KPMG documents call into question the very
10:20:19AM 3 assumptions they are using in the KPMG valuation of the
10:20:23AM 4 Americas transaction. In fact, you will see some meeting
10:20:26AM 5 notes where KPMG is concerned that the affiliate in
10:20:29AM 6 Puerto Rico I referred to earlier would not be operational
10:20:32AM 7 for 18 months after this transaction went into effect.
10:20:35AM 8 Someone writes, quote, "What can we do to make this thing
10:20:38AM 9 real?"

10:20:40AM 10 Now, your Honor, that is important, because if the IRS
10:20:45AM 11 has the legitimate purpose and has issued the summonses at
10:20:49AM 12 issue in good faith, then, unless Microsoft can show --
10:20:54AM 13 make a substantial showing of bad faith or wrongdoing with
10:20:58AM 14 respect to the summonses -- not with respect to some
10:21:01AM 15 flawed policy, but with respect to the summonses, then
10:21:04AM 16 Microsoft is simply not entitled to discovery in this
10:21:07AM 17 summons proceeding.

10:21:10AM 18 And, moreover, questions about the role of Quinn
10:21:13AM 19 Emanuel and the timing and the validity of the regulation
10:21:16AM 20 shrink and become secondary. And why is that? Because
10:21:20AM 21 they only become relevant about who your Honor may allow
10:21:23AM 22 to attend or to speak at an interview. But they don't go
10:21:28AM 23 to whether the interviews should themselves go forward.

10:21:32AM 24 Now, your Honor, let me just address quickly a couple
10:21:35AM 25 of points that Ms. Eakes made. It is true that we had

10:21:38AM 1 hoped in our telephone motions hearing, on the telephone a
10:21:42AM 2 few weeks ago, to produce a live witness to talk about the
10:21:47AM 3 interaction between the Microsoft audit and the
10:21:50AM 4 administrative record, essentially the temporary
10:21:53AM 5 regulation.

10:21:54AM 6 We had someone on our witness list, Mr. Vidano, but he
10:21:59AM 7 is an attorney. So we said, "Okay, we will produce him,
10:22:02AM 8 but he is an attorney -- an LB&I attorney. We want you to
10:22:06AM 9 agree, Microsoft, that we will not have a subject matter
10:22:09AM 10 waiver." That was the proposal. And Microsoft turned
10:22:12AM 11 that down.

10:22:13AM 12 So what we have done is, we have submitted the
10:22:16AM 13 administrative record here today, which is clearly put
10:22:20AM 14 together as best we can. I will address and point the
10:22:23AM 15 court to various parts of that self-authenticating record
10:22:28AM 16 later today.

10:22:31AM 17 Might I add, it is not typical to have a privilege log
10:22:33AM 18 with the submission of an administrative record.

10:22:36AM 19 And what is missing from the administrative record,
10:22:38AM 20 your Honor? Deliberative communications. Deliberative
10:22:44AM 21 communications are not supposed to be part of the
10:22:46AM 22 administrative record.

10:22:47AM 23 Ms. Eakes referred to a memo from A.M. Gulas, one of
10:22:53AM 24 the drafters of the regulation. That is a deliberative
10:22:56AM 25 and privileged document. So, of course, it is not in an

10:22:59AM 1 administrative record.

10:23:03AM 2 Your Honor, by the end of today we are confident that
10:23:06AM 3 your concerns, the ones expressed in your order, will be
10:23:09AM 4 alleviated, and it will be clear why the IRS legitimately
10:23:13AM 5 needs the additional information it seeks to complete this
10:23:16AM 6 audit. Thank you.

10:23:20AM 7 THE COURT: Thank you, Mr. Weaver. Are we ready
10:23:24AM 8 for our first witness then?

10:23:28AM 9 MR. BECK: Yes, your Honor.

10:23:29AM 10 THE COURT: Mr. Beck, you may call your first
10:23:31AM 11 witness.

10:23:32AM 12 MR. BECK: Microsoft calls Mr. Hoory.

10:23:36AM 13 THE COURT: Mr. Hoory, good morning. If I could
10:23:39AM 14 have you make your way around counsel table, come up in
10:23:43AM 15 front of the clerk, raise your right hand and be sworn
10:23:50AM 16 prior to taking the stand.

17 ELI HOORY

10:24:20AM 18 Having been sworn under oath, testified as follows:

10:24:20AM 19 THE CLERK: Could you please state your name for
10:24:22AM 20 the record and spell your last name?

10:24:23AM 21 THE WITNESS: Eli Hoory. The last name is spelled
10:24:27AM 22 H-O-O-R-Y.

10:24:29AM 23 THE COURT: Mr. Hoory, what I need from you is to
10:24:31AM 24 answer the questions in a voice loud enough so everybody
10:24:33AM 25 can hear you. That microphone in front of you amplifies

10:24:38AM 1 only a little bit, but there is a cone, and if you get too
10:24:42AM 2 close, you will get feedback. Keep your voice up. If you
10:24:45AM 3 don't understand the question, simply say so, and we will
10:24:47AM 4 get counsel to rephrase it for you. All right?

10:24:50AM 5 THE WITNESS: Um-hum.

10:24:51AM 6 THE COURT: You may inquire.

10:24:54AM 7 MR. BECK: Thank you, your Honor.

10:24:55AM 8 DIRECT EXAMINATION

10:24:56AM 9 By Mr. Beck:

10:24:57AM 10 Q. Mr. Hoory, I would like to start with a discussion
10:24:59AM 11 about the underlying dispute concerning Microsoft's tax
10:25:03AM 12 liability for the years 2004 through 2006. And I hope we
10:25:08AM 13 can keep it at a fairly general level, simply so the court
10:25:13AM 14 can understand the context in which today's dispute
10:25:17AM 15 arises.

10:25:17AM 16 Does the question that you and Microsoft have been
10:25:27AM 17 struggling over in the underlying audit concern how to
10:25:34AM 18 value intangibles that have been transferred by a U.S.
10:25:39AM 19 company to a foreign affiliate?

10:25:43AM 20 A. That is part of it. It is how to do that, as well as
10:25:46AM 21 how to measure relative values between buckets of
10:25:50AM 22 intangibles. So for that purpose we are actually using
10:25:54AM 23 the same valuation methodology.

10:25:56AM 24 Q. I am not asking you yet about the methodology. One
10:25:59AM 25 of the core issues is, as we have heard from Mr. Weaver,

10:26:03AM 1 there was intangible property, intellectual property, for
10:26:12AM 2 example, that was transferred from U.S. Microsoft to a
10:26:16AM 3 foreign subsidiary or affiliate. And one of the questions
10:26:21AM 4 at least is how to put a proper value on the property that
10:26:25AM 5 was transferred, correct?

10:26:27AM 6 A. That's one. There is also one other geography, the
10:26:31AM 7 Asia Pacific. They are similar issues.

10:26:33AM 8 Q. Now, you agree, don't you, that there is nothing
10:26:38AM 9 inherently improper in a U.S. company transferring
10:26:44AM 10 intangibles or intellectual property to a foreign
10:26:47AM 11 affiliate?

10:26:48AM 12 A. As long as they pay the arm's length price, that is,
10:26:51AM 13 the price that we pay in the market, then it is allowed.

10:26:54AM 14 Q. So the question is, have they paid -- did the foreign
10:26:58AM 15 affiliate pay an arm's length transaction-type price for
10:27:02AM 16 the property that was transferred, right?

10:27:05AM 17 A. That is part of it. Remember, in this case you have
10:27:08AM 18 the foreign affiliate doing a roundtrip. They buy the
10:27:11AM 19 intangible property from the United States, and they
10:27:14AM 20 immediately sell it right back to the U.S. affiliates,
10:27:16AM 21 which then have third-party relationships. So you have
10:27:19AM 22 two prices here, one going out, and then a roundtrip
10:27:22AM 23 coming back into the U.S.

10:27:23AM 24 Q. And neither of the transfers is inherently improper,
10:27:27AM 25 it is just a question of how to place the proper value on

10:27:30AM 1 the thing that was transferred, right?

10:27:32AM 2 A. That is true, unless we look beyond at economic
10:27:34AM 3 substance. So there are provisions that would let us
10:27:37AM 4 disregard the transaction. In this structure, though,
10:27:39AM 5 thus far, we have been focusing on what is the right price
10:27:42AM 6 if we actually respect the transaction as is.

10:27:44AM 7 Q. You say you respect the transaction. And you have
10:27:47AM 8 made no claim whatsoever at any time that this was some
10:27:51AM 9 sort of sham transaction that should be disregarded,
10:27:54AM 10 correct?

10:27:56AM 11 MR. WEAVER: Objection. Mischaracterizes his
10:27:58AM 12 testimony.

10:28:02AM 13 THE COURT: Overruled. Do you understand the
10:28:04AM 14 question?

10:28:06AM 15 THE WITNESS: If counsel could repeat it, I would
10:28:09AM 16 appreciate it.

10:28:10AM 17 THE COURT: Could I have you rephrase, counsel?

10:28:14AM 18 MR. BECK: Sure.

10:28:14AM 19 By Mr. Beck:

10:28:15AM 20 Q. I think you said thus far you respected the
10:28:17AM 21 transaction, right?

10:28:18AM 22 A. I said thus far in our valuation we have tried to
10:28:22AM 23 value it as if the transaction was respected. So you can
10:28:25AM 24 have alternative positions, as you might know. We have
10:28:28AM 25 said, "Okay, what if this is a real deal? What if there

1 is actually substance here? What would the value be
2 between arm's length parties if you respected it?" And we
3 basically started with that premise to try to engage in
4 productive resolution discussions with the company.

5 Q. Now, this audit has been going on since 2007, right?

6 A. I believe so.

7 Q. We are now in 2015. My question, sir, before you
8 volunteered this on the stand this morning, had anybody
9 from the IRS ever communicated to Microsoft any concern at
10 all that these transactions were anything other than
11 legitimate, and that the question is simply one of valuing
12 the thing that was transferred?

13 A. Well, if you look at my January 14 presentation I
14 gave the company, there is a number of simplifying
15 assumptions in there. One of those assumptions is, not
16 withstanding what we saw as a very little risk in the
17 Puerto Rican affiliate, we were going to treat it for
18 purposes of the resolution assumptions in that preliminary
19 analysis as if they actually were the owner of all, I
20 guess, features or rights inherent in the technology that
21 they purchased. So that was a simplifying assumption when
22 we presented to the company.

23 Q. Well, what you call now a simplifying assumption, is
24 you say, "We are proceeding on the basis that these are
25 legitimate transactions, and the only question is how to

10:29:52AM 1 value the thing that was transferred," right?

10:29:54AM 2 MR. WEAVER: Objection. Mischaracterizes his last
10:29:57AM 3 answer.

10:29:57AM 4 MR. BECK: He just was saying yes, your Honor.

10:30:00AM 5 THE COURT: Overruled.

10:30:02AM 6 THE WITNESS: Should I answer?

10:30:04AM 7 THE COURT: Yes.

10:30:05AM 8 THE WITNESS: Thank you, your Honor. I was
10:30:06AM 9 pointing out that it actually refers to simplifying
10:30:09AM 10 assumptions in the January 14th meeting. This is not the
10:30:14AM 11 first time I referred to them.

10:30:15AM 12 Mr. Beck:

10:30:15AM 13 Q. What you call the simplifying assumptions was, "We
10:30:19AM 14 are treating these transactions as perfectly legit, it is
10:30:24AM 15 how we put a value on the thing transferred," right?

10:30:26AM 16 A. We were treating them as qualified cost-sharing
10:30:29AM 17 arrangements for purposes of trying to value them. If we
10:30:32AM 18 had not treated them or looked beyond them at the
10:30:34AM 19 substance of the transaction and treated them as not
10:30:37AM 20 qualified cost-sharing arrangements, on that particular
10:30:39AM 21 point, if we have that premise, I was pointing out the way
10:30:42AM 22 the regs work is we don't have to respect the transfer of
10:30:47AM 23 the intangibles. You asked me if we had to respect it,
10:30:50AM 24 and that that was the only possible issue. I was just
10:30:51AM 25 pointing out that it was a simplifying assumption in our

1 presentation that we were respecting the transaction as
10:31:10AM 2 is, notwithstanding -- I was pointing out that it was a
10:31:12AM 3 simplifying assumption in our January 14th meeting. I
10:31:15AM 4 understood your earlier question to ask me if this was
10:31:19AM 5 permitted. The answer is, that is offshore transfers of
10:31:25AM 6 intangibles. That's what I understood you to ask. I was
10:31:29AM 7 pointing out it is permitted. We allow it under qualified
10:31:33AM 8 cost-sharing arrangements. And as a simplifying
10:31:35AM 9 assumption, when we did our valuation, our preliminary
10:31:38AM 10 assessment, which was not complete, it was not final, it
10:31:41AM 11 was supposed to be the starting point of resolution
10:31:44AM 12 discussions with the company, we made a simplifying
10:31:45AM 13 assumption that we were going to respect it as a qualified
10:31:49AM 14 cost-sharing arrangement.

10:31:49AM 15 Q. Well, lots of big U.S. companies have foreign
10:31:55AM 16 affiliates, right?

10:31:56AM 17 A. They do.

10:31:57AM 18 Q. And lots of big U.S. companies transfer intangibles
10:32:00AM 19 to foreign affiliates, correct?

10:32:02AM 20 A. They do. But in this case it is unusual, because you
10:32:05AM 21 have the roundtrip motion, where they are transferring it
10:32:07AM 22 out of the United States and then immediately transferring
10:32:09AM 23 it back in.

10:32:10AM 24 Q. And the transfers of intangibles to foreign
10:32:14AM 25 affiliates is so common in our economy that the IRS has an

entire group devoted solely to looking at these transactions, right?

A. Yeah, Transfer Pricing Operations was stood up to make sure that when multinationals were making these transfers, the prices were arm's length.

Q. Right. The core issue is, when you make these transactions, was the price arm's length, right?

A. Correct.

Q. And you mentioned the Transfer Pricing Operations. That's the group that you are in, right?

A. It is.

Q. Sometimes called TPO for short, right?

A. Yes.

Q. Now, Mr. Weaver talked about how when intangibles are transferred that the value -- the so-called arm's length value can be calculated in different ways. Were you here when he talked about that?

A. I know -- I don't recall exactly what he said. I know that there is an aim when we value these things to use the best method that is the most reasonable, accurate way of measuring arm's length price. And there are different methods. Depending on what your facts are, one method may be better than another.

Q. And without getting into the details of each method, there is something called the residual profit split

10:33:44AM 1 method, right?

10:33:45AM 2 A. Amongst others.

10:33:46AM 3 Q. Yes, amongst others. And one of the others is the
10:33:49AM 4 income method, right?

10:33:50AM 5 A. That is another option.

10:33:53AM 6 Q. And depending on which methodology you use, you could
10:33:58AM 7 come up with dramatically different values for the
10:34:04AM 8 intangibles that were transferred, right?

10:34:06AM 9 A. Of course. You look for the most accurate one given
10:34:10AM 10 your facts and circumstances. And, actually, even when
10:34:12AM 11 you are inside a method -- so two people can apply, for
10:34:19AM 12 example, a residual profits split method, sometimes I
10:34:22AM 13 might call it an RPSM for short, and come up with
10:34:26AM 14 different values based on the assumptions they make.

10:34:30AM 15 Q. Right. So using different methodologies could come
10:34:33AM 16 up with different values, and even using the same
10:34:36AM 17 methodology, depending on what assumptions or other inputs
10:34:41AM 18 you make, you could come up with dramatically different
10:34:43AM 19 values, right?

10:34:44AM 20 A. That's true. But the real question is whether those
10:34:47AM 21 dramatically different values are reasonable. And if you
10:34:49AM 22 look at all the facts and circumstances, it is possible to
10:34:52AM 23 come up with one or -- you know, some range that is
10:34:55AM 24 reasonable. And if you use assumptions that are
10:34:57AM 25 inaccurate, or make mistakes in your math computations, as

10:35:01AM 1 happened here, you could come up with values that don't
10:35:03AM 2 make any sense, at least not common sense.

10:35:06AM 3 Q. And incidentally, you and your group, you are not the
10:35:11AM 4 final arbiter of whether a particular value makes sense or
10:35:16AM 5 makes common sense, are you?

10:35:18AM 6 A. Well, we determine what the IRS's position is, that
10:35:21AM 7 is, what the IRS thinks is the right number. And, when
10:35:24AM 8 called for, my group is the one that will say what the
10:35:28AM 9 right number is for purposes of a statutory notice of
10:35:31AM 10 deficiency, if we issue one, or, if it goes to appeals, in
10:35:34AM 11 a 30-day letter. After that, obviously, a court can weigh
10:35:39AM 12 in at some point in time. Or if it goes to appeals,
10:35:42AM 13 appeals has an opportunity to consider our analysis and
10:35:47AM 14 enter into a hazards of litigation settlement with
10:35:50AM 15 taxpayers, should they choose, but they are not required
10:35:53AM 16 to.

10:35:53AM 17 Q. Well, courts don't just weigh in -- the tax court,
10:35:57AM 18 for example, they don't just weigh in after you have made
10:35:59AM 19 a determination. What happens is, if you make your own
10:36:03AM 20 determination, and the taxpayer has a determination, and
10:36:07AM 21 you two disagree, and you are not able to resolve it
10:36:12AM 22 through negotiations, it is submitted to the tax court,
10:36:16AM 23 and the tax court is the one that decides what the proper
10:36:19AM 24 value is, right?

10:36:20AM 25 A. Well, they look at our statutory notice of

10:36:22AM 1 deficiency. Normally we are entitled to -- I guess there
10:36:27AM 2 is a burden of proof. Normally -- Unless the taxpayer
10:36:30AM 3 can show that we are arbitrary and capricious, the number
10:36:33AM 4 on the statutory deficiency is supposed to basically be
10:36:37AM 5 upheld.

10:36:38AM 6 Q. How many cases under transfer pricing has the tax
10:36:41AM 7 court decided, where there has been a disagreement between
10:36:45AM 8 the IRS and the taxpayer on the value of the intangibles?

10:36:50AM 9 A. I am only aware of one recent case.

10:36:53AM 10 Q. And that would be the Veritas case that Mr. Weaver
10:36:57AM 11 referred to, right?

10:36:58AM 12 A. Yeah. That was one of the reasons we wanted to look
10:37:00AM 13 at this closer, so we could take into account the
10:37:02AM 14 arguments that Microsoft made in its protest, including
10:37:05AM 15 factual arguments about them saying RPSM was better. And
10:37:10AM 16 we wanted to consider that, so that when we came to our
10:37:14AM 17 recent decision about what the right number was, we had
10:37:16AM 18 actually addressed those issues and considered them.

10:37:18AM 19 Q. Well, in the one case that you are aware of in recent
10:37:21AM 20 years where this kind of issue has been presented to the
10:37:24AM 21 tax court, not only did the tax court disagree with the
10:37:29AM 22 IRS's determination, the tax court said that the IRS had
10:37:35AM 23 acted arbitrarily and capriciously in reaching that
10:37:38AM 24 determination, correct?

10:37:39AM 25 A. Well, the tax court said that our analysis of the

10:37:43AM 1 facts and circumstances was arbitrary and capricious, and
10:37:45AM 2 they criticized us for relying on one expert. The
10:37:49AM 3 taxpayer in that case, I think, they had four or five
10:37:52AM 4 experts. We obviously could do a better job presenting
10:37:55AM 5 complex multifaceted cases, as shown in that court's
10:37:59AM 6 criticisms.

10:38:00AM 7 Q. I take it you would agree that, even today, when you
10:38:09AM 8 are trying to do a better job, the mere fact that the IRS
10:38:14AM 9 and Microsoft disagree about the value of the intangibles
10:38:20AM 10 that were transferred, and thus the tax liability, that
10:38:24AM 11 doesn't mean that the IRS is right and Microsoft is wrong,
10:38:27AM 12 does it?

10:38:27AM 13 A. It depends on what you are focusing on. I have
10:38:31AM 14 identified some things where they are saying inaccurate
10:38:33AM 15 statements in their SEC filings for growth versus what
10:38:36AM 16 they use in their valuation, four percent on their
10:38:39AM 17 valuation versus ten to twelve in their SEC reports. We
10:38:44AM 18 have identified some errors math, which clearly seem like
10:38:47AM 19 errors on Microsoft's part. Those are the kinds of things
10:38:50AM 20 we wanted to engage with Microsoft on, and ask them, "Do
10:38:53AM 21 you really think your numbers are right?", or, "Did you
10:38:55AM 22 make the math errors we pointed out?" "Did you use
10:38:58AM 23 valuation assumptions that were inconsistent with your
10:39:01AM 24 public filings?"

10:39:01AM 25 Q. Incidentally, Microsoft has pointed out math errors,

10:39:05AM 1 and other errors that you have made, too, right?

10:39:08AM 2 A. I am aware of one they pointed out at the
10:39:11AM 3 January 14th presentation. I thanked them and invited
10:39:14AM 4 them to engage on that issue, as well as others.

10:39:15AM 5 Q. In any event, my question was, at the end of the day,
10:39:22AM 6 if you have come up with a tax liability that is
10:39:26AM 7 substantially larger than what Microsoft not only believes
10:39:31AM 8 its tax liability was, but has already paid, then that
10:39:34AM 9 doesn't mean that you're right and Microsoft is wrong,
10:39:37AM 10 that is up to the tax court to decide, right?

10:39:39AM 11 A. If it goes to tax court. But the onus on the IRS in
10:39:44AM 12 the first instance is to say what we think the right
10:39:46AM 13 number is, and to put that right number on a statutory
10:39:48AM 14 notice of deficiency -- or on a 30-day letter first, and
10:39:51AM 15 then on a stat notice if it doesn't get agreed to at
10:39:55AM 16 appeals. Here, we are still trying to get that right
10:39:57AM 17 number. And we want to make sure, given the size of this
10:40:00AM 18 case, the largest I am aware of in the IRS's history, at
10:40:04AM 19 least personally, that we actually kick the tires, and put
10:40:08AM 20 the resources in, and ask the questions, and look at the
10:40:10AM 21 information we need to to make sure that when we put a
10:40:13AM 22 number on the page, it is our reasoned judgment based on
10:40:17AM 23 the facts and circumstances that were available.

10:40:19AM 24 Q. So no matter what someone might say here at the
10:40:26AM 25 lectern about the size of the potential tax liability, you

1 haven't even made a determination of that yet, right?

2 A. We are still working on getting to the right number.

3 There are some issues we obviously raised and wanted to

4 engage on on the Americas. That was the purpose of the

5 January 14th presentation, which was a preliminary

6 analysis with some open questions. And also on the Asia

7 Pacific deal, which we never reached resolution

8 discussions with the company on, because they shut us down

9 on Americas before we could start engaging with them on

10 other issues. Those have significant open factual

11 questions, which could materially impact what the right

12 number is, which we are still trying to get to that right

13 number.

14 Q. Now, Mr. Weaver mentioned the Veritas case, and you

15 said it is the one that you knew of that has actually been

16 resolved by the tax court. Are you familiar with the

17 Amazon case also?

18 A. I am. I thought you were referring to decisions, as

19 opposed to currently ongoing litigation.

20 Q. I was. This is a different matter. The Amazon case,

21 that is also about transfer pricing, right?

22 A. It is.

23 Q. Where Amazon transferred intangibles to a foreign

24 affiliate, and Amazon said we think the value is X, and

25 the IRS said we think the value is some multiple of that,

10:41:47AM 1 right?

10:41:48AM 2 A. I believe so. I can't discuss other taxpayers'
10:41:53AM 3 cases. I am sort of limited to what I know from the
10:41:55AM 4 public filings.

10:41:56AM 5 Q. We will keep it limited to what you know from the
10:41:58AM 6 public information. What you do know is that the IRS and
10:42:04AM 7 Amazon were at loggerheads, and they are now in front of
10:42:09AM 8 the tax court, right?

10:42:10AM 9 A. Certainly.

10:42:11AM 10 Q. And that Amazon, just like Veritas, is saying that
10:42:17AM 11 the results that the IRS came up with are arbitrary and
10:42:22AM 12 capricious, right?

10:42:23AM 13 A. I imagine the IRS is holding the same true for
10:42:27AM 14 Amazon's valuation, as being inaccurate and arbitrary as
10:42:29AM 15 well. People disagree in court.

10:42:32AM 16 Q. And it is the court that decides it, not the IRS,
10:42:35AM 17 right?

10:42:35AM 18 A. Well, the IRS isn't a court. Obviously in this case
10:42:42AM 19 Amazon is before the tax court.

10:42:43AM 20 Q. Now, we heard from Mr. Weaver that, well, the reason
10:42:54AM 21 that Mr. Hoory and the Transfer Pricing Operations people
10:43:03AM 22 hired Quinn Emanuel is because they really want to make
10:43:10AM 23 sure that the audit was done correctly. Did you hear him
10:43:16AM 24 say that?

10:43:17AM 25 A. I don't recall him saying those words.

10:43:19AM 1 Q. Well, no, not those words. But didn't you get the
10:43:24AM 2 impression from Mr. Weaver that his story is that the real
10:43:30AM 3 reason that you got Quinn Emanuel involved was because
10:43:35AM 4 there had been foul-ups in the Veritas audit, and they
10:43:39AM 5 hadn't done a good job putting all the facts together, and
10:43:44AM 6 so you wanted to hire a commercial litigator who could do
10:43:48AM 7 a good job of analyzing all these facts during the
10:43:51AM 8 examination, i.e., during the audit?

10:43:54AM 9 A. What I heard him say, and the way I think about the
10:43:57AM 10 Quinn Emanuel contract, is that we recognize that transfer
10:44:01AM 11 pricing cases are very complex, they deal with very
10:44:04AM 12 complex facts, lots of different issues. In this case we
10:44:07AM 13 knew that we needed multiple experts to get to what the
10:44:10AM 14 right number was, as well as lots of information. And we
10:44:13AM 15 thought that a commercial litigator with experience in
10:44:17AM 16 very complex cases could bring some value to the table,
10:44:20AM 17 first in providing a sounding board, a gut check for the
10:44:23AM 18 IRS, look at what we have done to date, and what the
10:44:26AM 19 taxpayer put on the table, and make observations,
10:44:30AM 20 hopefully thoughtful, helpful ones, that would ask good
10:44:33AM 21 questions. And if we had open areas that we needed to
10:44:35AM 22 develop further, or things that didn't make sense, we
10:44:38AM 23 wanted to know that, and do the best job we could to get
10:44:41AM 24 to the right number. That is why we hired Quinn Emanuel
10:44:44AM 25 at the examination stage, to provide that kind of legal

10:44:47AM 1 consultation and advice, which it appeared would be
10:44:50AM 2 something that a complex commercial litigator would have.

10:44:55AM 3 THE COURT: Mr. Beck, let's go ahead and take our
10:44:58AM 4 morning recess for our court reporter at this point in
10:45:00AM 5 time. We will come back in 15 minutes.

11:06:18AM 6 (Break.)

11:06:18AM 7 THE COURT: Counsel, we are back in session.
11:06:21AM 8 Mr. Beck.

11:06:24AM 9 MR. BECK: Thank you, your Honor.

11:06:26AM 10 By Mr. Beck:

11:06:26AM 11 Q. When we left off we were talking about what
11:06:29AM 12 Mr. Weaver had said and what you had said on the stand
11:06:31AM 13 about what Quinn Emanuel was hired for. My notes from
11:06:37AM 14 Mr. Weaver's opening, he said that you decided to hire
11:06:42AM 15 some other types of experts in 2012 to help with the
11:06:46AM 16 examination for the audit, right?

11:06:50AM 17 A. Yes.

11:06:52AM 18 Q. And that later on you decided that it would also be
11:06:56AM 19 useful in the examination or audit to have the services of
11:07:02AM 20 a commercial litigator, right?

11:07:03AM 21 A. Correct. Initially we pursued Boies Schiller.

11:07:08AM 22 Q. And Boies -- David Boies had some sort of a conflict,
11:07:13AM 23 so I guess your next pick was John Quinn, right?

11:07:16AM 24 A. Yeah. We looked for other people with similar
11:07:18AM 25 expertise, because we still saw value in that expertise,

11:07:23AM 1 and eventually we picked Quinn Emanuel.

11:07:25AM 2 Q. And, again, getting back to what Mr. Weaver said and
11:07:28AM 3 what you said on the stand, you both said that the reason
11:07:31AM 4 that you hired Quinn Emanuel was to reach sound
11:07:36AM 5 conclusions in the examination, in the audit, right?

11:07:40AM 6 A. That was the initial focus, and that was the contract
11:07:44AM 7 that was actually awarded, was for examination support and
11:07:48AM 8 evaluation.

11:07:48AM 9 Q. And as I wrote it down, Mr. Weaver said, to be clear,
11:07:53AM 10 if the examination was not resolved at the audit stage,
11:08:01AM 11 these same lawyers might be involved in later litigation?

11:08:06AM 12 A. That's right. That is the same as any expert.

11:08:09AM 13 Whenever we hire an expert at the examination stage, we
11:08:12AM 14 always want to make sure that they are someone that we
11:08:14AM 15 would trust, if we were not to reach resolution with the
11:08:17AM 16 taxpayer, and if the case would go forward, whether to
11:08:21AM 17 appeals or to tax court.

11:08:23AM 18 Q. Actually, sir, wasn't it kind of the other way
11:08:26AM 19 around, where the endgame and core purpose of hiring Quinn
11:08:33AM 20 Emanuel was for them to represent you in the tax court,
11:08:39AM 21 and their involvement at the audit stage was just a way
11:08:44AM 22 for them to take some free pretrial discovery that they
11:08:48AM 23 could never get out of the tax court?

11:08:49AM 24 A. That is incorrect.

11:08:51AM 25 Q. Well, who is John Koskinen? I may be pronouncing

11:09:00AM 1 that incorrectly.

11:09:01AM 2 A. He is the current commissioner of the IRS.

11:09:03AM 3 Q. He is like your boss' boss' boss?

11:09:09AM 4 A. Do you want me to count?

11:09:11AM 5 Q. Well, he is the top man at the IRS, right?

11:09:13AM 6 A. Yeah, he is three or four levels above.

11:09:17AM 7 Q. The top person at the IRS, correct?

11:09:19AM 8 A. That is my understanding.

11:09:22AM 9 Q. Let's take a look at what he said on this subject,
11:09:27AM 10 looking at our Exhibit 54, which is an article from Tax
11:09:32AM 11 Notes.

11:09:37AM 12 MR. WEAVER: Objection. Foundation, your Honor.

11:09:48AM 13 THE COURT: I don't know what question you are
11:09:50AM 14 going to ask him, Mr. Beck.

11:09:55AM 15 MR. BECK: I am going to show him what
11:09:57AM 16 Mr. Koskinen said, and ask him whether he agrees with
11:10:01AM 17 that.

11:10:02AM 18 MR. WEAVER: If Mr. Hoory recognizes this
11:10:04AM 19 document, that would be fine. But that assumes that
11:10:06AM 20 Mr. Koskinen said what he said, and Mr. Hoory is familiar
11:10:10AM 21 with this document.

11:10:11AM 22 MR. BECK: Your Honor, we are also in a hearing,
11:10:13AM 23 the purpose of which is to determine whether we should be
11:10:17AM 24 allowed to take some discovery in this case.

11:10:19AM 25 THE COURT: Mr. Beck, I'm fine. Counsel, while

11:10:23AM 1 the rules of evidence obviously apply, they will be
11:10:27AM 2 relaxed to a certain extent simply because of the purposes
11:10:30AM 3 of this particular hearing. We will allow your
11:10:34AM 4 questioning, Mr. Beck.

11:10:35AM 5 MR. BECK: Thank you.

11:10:36AM 6 By Mr. Beck:

11:10:39AM 7 Q. So here in this publication it indicates there in the
11:10:42AM 8 highlighted portion that Commissioner Koskinen was
11:10:48AM 9 speaking in Washington at the Annual Institute on Current
11:10:52AM 10 Issues in International Taxation. Do you see that?

11:10:58AM 11 A. I see the sentence.

11:10:59AM 12 Q. Were you there by any chance?

11:11:02AM 13 A. I was not.

11:11:03AM 14 Q. Over here on Page 3, on outsourcing audit work --
11:11:17AM 15 Let me blow that up a little bit. Speaking with tax
11:11:21AM 16 analysts after the session, Koskinen defended the IRS's
11:11:27AM 17 decision to outsource \$2 million of work on Microsoft's
11:11:30AM 18 transfer pricing audit to the law firm Quinn Emanuel. And
11:11:36AM 19 then down below in the highlighted portion quotes the
11:11:39AM 20 commissioner as saying, "One of the things that we have to
11:11:43AM 21 do is show up in tax court," the commissioner said. "We
11:11:48AM 22 can't default the government's position simply because we
11:11:51AM 23 have 20 percent fewer members of the Office of Chief
11:11:54AM 24 Counsel than we used to have. The one place we can't cut
11:11:57AM 25 resources is in tax litigation."

11:12:00AM 1 Now, in fact, sir, wasn't the core purpose and
11:12:04AM 2 justification for spending \$2 million on Quinn Emanuel was
11:12:09AM 3 that you wanted them to be your trial lawyers in tax court
11:12:13AM 4 down the road?

11:12:15AM 5 A. Let me be very clear. Quinn Emanuel was hired for
11:12:19AM 6 examination support and to help with the evaluation. We
11:12:22AM 7 knew there was a possibility, just like in any case -- any
11:12:25AM 8 audit, any examination, that there would be a
11:12:28AM 9 disagreement. And whenever there is a disagreement -- In
11:12:30AM 10 this case that seemed likely, given the past history and
11:12:33AM 11 the size and the difference of issues, notwithstanding
11:12:36AM 12 that we thought we still needed to do work to get the
11:12:38AM 13 right number, and notwithstanding that we wanted to have
11:12:40AM 14 resolution, that we might not agree with the taxpayer at
11:12:43AM 15 the end of the day, and we might not seek resolution.

11:12:45AM 16 In that case -- In every case, the IRS, the
11:12:48AM 17 examination function that I work for, we need to come up
11:12:51AM 18 with the right number and present it well. And we need to
11:12:54AM 19 make sure that we have the right facts. The first step is
11:12:57AM 20 always to get to that right number.

11:12:59AM 21 And once we put that right number down on paper,
11:13:01AM 22 whether it goes to appeals or tax court, we have to defend
11:13:03AM 23 it. If it doesn't go to appeals, and it goes to tax
11:13:07AM 24 court, we have to be prepared to litigate.

11:13:09AM 25 And when we don't develop cases as well as we might

1 otherwise have, and we put a number on the paper that
2 isn't fully supported by the facts, or we haven't fully
3 developed the facts, in those situations we are not ready
4 to defend it, whether it is in appeals or in court. So
5 our goal is to get to the right number and be ready for
6 whatever comes.

7 Q. In the Veritas case, the lawyers who represented the
8 IRS in tax court were lawyers from the IRS Chief Counsel's
9 office, right?

10 A. Yes.

11 Q. And before you hired Quinn Emanuel, had you in fact
12 discussed with colleagues in the IRS your view that the
13 lawyers from the Chief Counsel's office had not done a
14 very good job in the Veritas tax court case?

15 A. What I discussed with colleagues was that the Veritas
16 tax court case seemed to highlight a number of areas we
17 could do better in, particularly our development of the
18 facts, us actually diving into the taxpayer's methodology
19 and testing it, to look at the activities that the
20 companies performed. In that case they focused a lot on
21 sales and marketing activities performed by the European
22 affiliate.

23 Here, we really needed to dive into the sales and
24 marketing activities that the U.S. continued to perform.
25 We thought we could do a better job presenting it, and

11:14:44AM 1 bringing better expertise to the table.

11:14:46AM 2 In Veritas we relied, from my understanding at
11:14:47AM 3 least -- and I only know what is in the tax court opinion,
11:14:50AM 4 since I wasn't privy to the case, the IRS relied on a
11:14:53AM 5 single economist expert. On the other side they had an
11:14:55AM 6 economist, they had a code expert, they had a marketing
11:14:58AM 7 expert, and they had a financial expert. We clearly could
11:15:02AM 8 do a better job bringing the right expertise to bear and
11:15:07AM 9 developing the facts and presenting them.

11:15:08AM 10 We thought that litigators who have experience with a
11:15:15AM 11 large bandwidth of cases of that variety, that complexity,
11:15:19AM 12 would be more likely, day in and day out, to have
11:15:22AM 13 encountered those kinds of issues and could bring some
11:15:24AM 14 value to the table.

11:15:25AM 15 We don't litigate a lot of transfer pricing cases. As
11:15:29AM 16 I mentioned, Veritas is the only real fact-intensive case
11:15:34AM 17 that I am aware of having been decided in the last decade
11:15:37AM 18 or so.

11:15:38AM 19 Q. In all that long answer of yours, that all related to
11:15:40AM 20 what happened in the tax court, right?

11:15:42AM 21 A. Yeah. We need to put the right number and support it
11:15:45AM 22 when we issue -- whether it is, frankly, a 30-day letter
11:15:49AM 23 or a statutory notice of deficiency. So we need to make
11:15:52AM 24 sure we have done our job when we put a number on the
11:15:55AM 25 paper. If we don't do that, then it is not going to stand

up in any forum, whether it is appeals or tax court.

Q. Please listen to my question carefully and see if you can answer it. Did you talk with colleagues at the IRS before you hired Quinn Emanuel about your concern that the folks from the Chief Counsel's office of the IRS had not done a good enough job in the tax court?

MR. WEAVER: Objection, to the extent that the question calls for privileged communications with IRS counsel or deliberative communications.

THE COURT: Are you asking him to state whether or not that was his opinion?

MR. BECK: I will ask it that way.

By Mr. Beck:

Q. It was your opinion, was it not, sir, setting aside any questions about how the audit was conducted, that the lawyers from the Chief Counsel's office in the IRS had not done a good job in the tax court?

A. If you are asking me for my opinion, my opinion, looking at the outcome of Veritas, was that the opinion highlighted a number of areas that the IRS as a whole could do better at. And one of the key pieces was that we switched positions between our examination piece and the counsel piece. Obviously counsel had a role to play in that, just like examination had a role to play in the outcome of that decision. We, the IRS as a whole, it

11:17:33AM 1 looked like we could do a better job developing the facts.
11:17:36AM 2 If that means that counsel could have done a better job,
11:17:39AM 3 then, certainly, they could have done a better job as
11:17:41AM 4 well, just like exam could do a better job. And that's
11:17:46AM 5 what we are trying to do.

11:17:47AM 6 Q. Did you tell people in the IRS -- not in any
11:17:49AM 7 privileged communication, lawyer-client, did you tell your
11:17:54AM 8 colleagues that we need to bring in David Boies or John
11:17:57AM 9 Quinn, or whomever, because the guys who did the job in
11:18:02AM 10 the tax court fouled it all up and we want first-class
11:18:06AM 11 trial lawyers in the tax court?

11:18:12AM 12 A. I don't recall ever making those statements.

11:18:14AM 13 Q. I am not asking word for word. Did you say that in
11:18:17AM 14 substance to anybody at the IRS, other than if you were
11:18:22AM 15 seeking legal advice?

11:18:25AM 16 MR. WEAVER: Objection to the extent that the
11:18:29AM 17 question calls for deliberations that are pre-decisional
11:18:32AM 18 in nature.

11:18:35AM 19 MR. BECK: Your Honor, I guess that doesn't make
11:18:37AM 20 any sense to me. The idea about whether he told somebody
11:18:40AM 21 that we need good lawyers in the tax court because the
11:18:43AM 22 other guys fouled it up, it is inconceivable to me how
11:18:49AM 23 that could be pre-deliberative as to any decision.

11:18:52AM 24 THE COURT: The objection will be overruled.
11:18:54AM 25 Mr. Hoory, can you answer the question? Did you ever make

11:18:56AM 1 that kind of statement?

11:18:57AM 2 THE WITNESS: I don't believe so. The kind of
11:18:59AM 3 statements that I recall making are consistent with what I
11:19:01AM 4 just explained, that we thought that people with more
11:19:05AM 5 expertise, more volume of cases, who worked with these
11:19:09AM 6 multifaceted, very complex issues, whether it was
11:19:13AM 7 intellectual property or antitrust, they could bring value
11:19:16AM 8 to the table. That was the premise. That was the value
11:19:18AM 9 we saw in bringing a Boies Schiller or a Quinn Emanuel to
11:19:23AM 10 give us their legal advice and consultation, to bring that
11:19:26AM 11 expertise. Because at the IRS we simply don't deal with
11:19:30AM 12 that volume, we don't litigate that many cases.

11:19:32AM 13 Mr. Beck:

11:19:32AM 14 Q. And give me the names of the people that you say you
11:19:35AM 15 said that to in case we get discovery and we can inquire
11:19:39AM 16 as to what they recollect you saying. Who did you have
11:19:44AM 17 these conversations with?

11:19:46AM 18 A. So obviously we discussed the premise with
11:19:50AM 19 Mr. Maruca. He is my boss. We had some discussions, I
11:19:58AM 20 would say, at some point, with Mr. Maruca's boss,
11:20:09AM 21 Mr. Danilack. At some point we eventually discussed it
11:20:13AM 22 with Ms. Maloy. On the counsel side, we discussed it
11:20:21AM 23 with, you know, various persons, in counsel as well.

11:20:27AM 24 Q. Moving on to another subject here. You understand
11:20:34AM 25 that one of the big questions in whether your summonses

11:20:43AM 1 should be enforced is whether private attorneys at Quinn
11:20:50AM 2 Emanuel can put people under oath and take testimony from
11:20:52AM 3 them, right?

11:20:53AM 4 A. I understand it to be that whether contractors that
11:20:57AM 5 we hire, whether it is Quinn Emanuel or our substantive
11:21:01AM 6 experts, who were also in attendance at these interviews,
11:21:04AM 7 could ask questions at summons interviews that the IRS has
11:21:08AM 8 requested of taxpayers, or third parties.

11:21:10AM 9 Q. Well, there are interviews and then there are
11:21:16AM 10 interviews where people are put under oath and give sworn
11:21:19AM 11 testimony. You understand those are two different
11:21:22AM 12 animals, right?

11:21:22AM 13 A. Well, there is Q&A and formal Q&A that is not under
11:21:27AM 14 oath, and then there is question and answer that is under
11:21:30AM 15 oath. The only reason I was distinguishing what you said
11:21:32AM 16 from my understanding was because you suggested, or at
11:21:34AM 17 least I understood you to suggest, that Quinn Emanuel was
11:21:37AM 18 placing these people under oath. And that is not what
11:21:39AM 19 happens.

11:21:39AM 20 Q. It is not who places them under oath. I am trying to
11:21:44AM 21 focus on who is going to be asking the questions. And
11:21:48AM 22 what you have told Microsoft in no uncertain terms is that
11:21:52AM 23 if these summonses are enforced, Quinn Emanuel can fully
11:21:58AM 24 participate and take the lead, being the people asking the
11:22:04AM 25 questions and taking the testimony, right?

11:22:06AM 1 A. What I told them was that all of our experts would be
11:22:12AM 2 free, if we asked them to, to attend the interviews and
11:22:15AM 3 fully participate by asking questions. That includes our
11:22:19AM 4 industry experts as well.

11:22:20AM 5 Q. I am just asking about Quinn Emanuel. Didn't you
11:22:22AM 6 tell them that if these summonses are enforced, Quinn
11:22:26AM 7 Emanuel is going to be, from your point of view, able to
11:22:30AM 8 attend all of these depositions or sworn interviews and be
11:22:36AM 9 the ones who ask the questions and get the answers?

11:22:39AM 10 A. Amongst other people, yes. I said that they would
11:22:44AM 11 attend if I asked them to, and that they may fully
11:22:47AM 12 participate, just like it says in the regulation.

11:22:49AM 13 Q. You said, "like it says in the regulation." Your
11:22:52AM 14 legal basis, justification for saying that Quinn Emanuel
11:22:59AM 15 ought to be able to do that is this temporary regulation
11:23:01AM 16 you referred to, right?

11:23:03AM 17 MR. WEAVER: Objection. Calls for legal analysis.
11:23:05AM 18 This is a fact witness, your Honor.

11:23:07AM 19 THE COURT: The objection as to the form will be
11:23:10AM 20 sustained.

11:23:13AM 21 By Mr. Beck:

11:23:13AM 22 Q. When you say as the regulation says, what are you
11:23:16AM 23 talking about in your answer to me? When you volunteered
11:23:22AM 24 that this was all as provided for in the regulation, what
11:23:25AM 25 are you talking about?

11:23:26AM 1 A. It is the same regulation that is referred to in
11:23:29AM 2 correspondence between myself and Mr. Bernard or
11:23:33AM 3 Mr. O'Brien. I think, if I have it right, it is
11:23:41AM 4 301.7602-1, subparagraph something or other.

11:23:45AM 5 Q. In fact, you, when writing to Microsoft -- And they
11:23:53AM 6 had objected to Quinn Emanuel participating in any kind of
11:23:57AM 7 asking questions on sworn testimony, right?

11:24:00AM 8 A. At some point they did, yes.

11:24:02AM 9 Q. And what you did is, you wrote back and you said, "As
11:24:07AM 10 you no doubt are aware, this is authorized under the
11:24:11AM 11 temporary regulation," right?

11:24:12AM 12 A. I wanted to make sure they were aware of it, yes.

11:24:14AM 13 Q. Your position, as you communicated to Microsoft, was
11:24:17AM 14 that the authority for Quinn Emanuel to ask questions and
11:24:24AM 15 take testimony was this temporary regulation, right?

11:24:27AM 16 MR. WEAVER: Objection, your Honor. Again, the
11:24:29AM 17 framing of the question calls for legal authority. It is
11:24:32AM 18 not a fact question.

11:24:35AM 19 MR. BECK: I asked what he communicated to
11:24:37AM 20 Microsoft.

11:24:37AM 21 THE COURT: The objection will be overruled. Is
11:24:40AM 22 that what you told Microsoft?

11:24:42AM 23 THE WITNESS: I think my letter clearly refers to
11:24:44AM 24 the regulation. And it says -- assumes that they are
11:24:48AM 25 aware of it, because they are a very sophisticated

1 taxpayer, and they are advised by sophisticated tax
2 counsel. If they didn't, it obviously made them aware of
3 it. I don't know if they were or were not aware of it at
4 that point.

5 Mr. Beck:

6 Q. I didn't ask whether they were aware or not aware of
7 it. What I asked is, when Microsoft objected to Quinn
8 Emanuel taking sworn testimony, what you said to Microsoft
9 is that the authority for Quinn Emanuel to do that is in
10 the temporary regulation; isn't that true?

11 A. I don't remember my exact phrasing. I certainly said
12 that the reg permits our experts to attend and fully
13 participate.

14 Q. Well, we will come back to your exact phrasing a
15 little later. Let's take a look at the regulation here.
16 Just the title of it says, "Participation of a person
17 described in Section 6103(n) in a summons interview under
18 Section 7602(a)(2) of the Internal Revenue Code." Do you
19 see that?

20 A. I do.

21 Q. You are familiar with both of these provisions,
22 right?

23 A. I can't quote them to you, but basically.

24 Q. But you are familiar with them, aren't you?

25 A. I said "basically."

11:26:21AM 1 Q. Incidentally, you are a lawyer, right?

11:26:24AM 2 A. I am an attorney, but I don't work as an attorney in
11:26:28AM 3 my current capacity.

11:26:30AM 4 Q. You are in fact trained as a tax lawyer, right?

11:26:33AM 5 A. I have experience as a tax attorney.

11:26:36AM 6 Q. Years and years of experience as a tax attorney,
11:26:38AM 7 right?

11:26:39AM 8 A. Probably about ten -- Well, I practiced for six
11:26:44AM 9 years or so.

11:26:45AM 10 Q. At one of the leading firms in the country, right?

11:26:48AM 11 A. Thank you.

11:26:52AM 12 Q. Covington & Burling, right?

11:26:54AM 13 A. Yes.

11:26:55AM 14 Q. As a tax attorney all that time, right?

11:26:57AM 15 A. Yes.

11:26:58AM 16 Q. Now, do you understand that Section 7602 is about who
11:27:04AM 17 can take testimony in a summons interview?

11:27:18AM 18 MR. WEAVER: Your Honor, let me just object. To
11:27:20AM 19 the extent that Mr. Hoory is going to be used as a witness
11:27:23AM 20 to interpret the reg, I believe that is improper. If it
11:27:29AM 21 is his understanding as it relates to the Microsoft audit,
11:27:32AM 22 fine. I don't know that it is relevant. I am worried
11:27:35AM 23 that Mr. Hoory is being set up here, because of his legal
11:27:39AM 24 experience, to somehow now start opining on behalf of the
11:27:42AM 25 IRS about this reg. That is not appropriate.

11:27:44AM 1 THE COURT: Thank you. Mr. Beck, I don't believe
11:27:52AM 2 that is where you are going, right? We are trying to get
11:27:55AM 3 to the factual answers here, correct?

11:27:58AM 4 MR. BECK: Yes. But I think, your Honor, part of
11:28:01AM 5 the question concerning whether there was a proper purpose
11:28:04AM 6 and whether this was abusive requires a basic
11:28:08AM 7 understanding of the statutory scheme, which this
11:28:12AM 8 gentleman clearly had. And he participated, in fact, in
11:28:16AM 9 reviewing regulations that purported to be based on these
11:28:25AM 10 statutory provisions. So as a factual matter, he had to
11:28:29AM 11 have some kind of understanding of the statute in order to
11:28:34AM 12 participate in the deliberations concerning the
11:28:36AM 13 regulations.

11:28:36AM 14 THE COURT: His understanding of the statute is
11:28:38AM 15 not at issue. It will be up to the court to make that
11:28:42AM 16 determination. His understanding of the statute as to how
11:28:44AM 17 it affects what he may have done factually is relevant
11:28:49AM 18 here. If that's the way you want to go, then fine.
11:28:53AM 19 Otherwise, Mr. Weaver's objection is correct.

11:28:56AM 20 MR. BECK: Well, I actually wanted to kind of
11:29:00AM 21 debate him about the meaning of the statute.

11:29:03AM 22 THE COURT: I don't see why you want to waste the
11:29:05AM 23 time. It will be up to me to decide what that statute
11:29:08AM 24 means.

11:29:13AM 25 By Mr. Beck:

11:29:14AM 1 Q. Let me ask you, 7602 -- And this really is directed
11:29:19AM 2 towards factual testimony. You heard Mr. Weaver's
11:29:24AM 3 explanation of -- his interpretation of 7602, correct?

11:29:28AM 4 A. During his opening, yes.

11:29:30AM 5 Q. Now, for years, the industry experts, like
11:29:38AM 6 economists, and engineers, and accountants had
11:29:42AM 7 participated in summons interviews, right?

11:29:47AM 8 A. That's my understanding.

11:29:50AM 9 Q. But is it also your understanding as a factual matter
11:29:55AM 10 that these summons interviews where experts participated
11:30:04AM 11 in were never -- almost never under oath?

11:30:12AM 12 A. I can only speak to my tenure at the IRS. What I can
11:30:18AM 13 tell you is that when we stood up TPO and looked at what
11:30:24AM 14 we could do better, one of the things we noticed was that
11:30:27AM 15 we had difficulty referring to interviews because some
11:30:30AM 16 were under oath and some were not. And particularly on
11:30:34AM 17 the ones that were not, you know, similar to the point
11:30:37AM 18 that Microsoft made in its protest, you know, basically it
11:30:41AM 19 is tough to rely on someone's handwritten notes, what is
11:30:47AM 20 in there, what is not. Somebody who is not part of the
11:30:49AM 21 examination and not actually at the interview can't really
11:30:52AM 22 evaluate those notes. If we are trying to develop it and
11:30:55AM 23 give it to another expert that we bring on board later, we
11:30:57AM 24 really need a transcript, if we think we are going to rely
11:31:01AM 25 on that.

11:31:01AM 1 Similarly, if we send the case to appeals, the appeals
11:31:05AM 2 officer really needs a transcript to see what was said.
11:31:08AM 3 So one of the goals we had was, notwithstanding that in
11:31:11AM 4 the past at the examination stage we had not done
11:31:15AM 5 transcripts that often -- In other words, it wasn't that
11:31:17AM 6 it never happened, it just didn't happen that often. One
11:31:20AM 7 of the pushes was, if you get to the stage that you need
11:31:22AM 8 to talk to people, like after you have just done the
11:31:24AM 9 preliminary back and forth to try to ask intelligent
11:31:28AM 10 questions, if you still have material issues in dispute,
11:31:31AM 11 one of the pushes we started to make was to have them
11:31:34AM 12 under oath on a transcript so there would be a record.

11:31:37AM 13 Q. Well, you didn't really start to make that push until
11:31:41AM 14 you hired Quinn Emanuel in the Microsoft audit, right?

11:31:45AM 15 A. That's incorrect. We made that push in other cases.
11:31:49AM 16 In Microsoft we were trying to use resources efficiently
11:31:54AM 17 and to respect not just our use of our own resources, but
11:31:58AM 18 the company's requests of us, and the fact that the audit
11:32:04AM 19 had gone on for a while, and that we were trying to
11:32:07AM 20 resolve and narrow issues. Mr. Bernard was actually the
11:32:11AM 21 one who asked me to only use informal interviews very
11:32:17AM 22 early on us reopening the case, withdrawing the 30-day
11:32:18AM 23 letter. He is the one who said, "Hey, this has worked out
11:32:21AM 24 well for Microsoft in the past, you know, you guys seemed
11:32:23AM 25 to get what you wanted, how about we do this?" And I

11:32:24AM 1 agreed, subject to the caveat, which is reflected in our
11:32:27AM 2 updated timelines after that occurred, that we reserve the
11:32:31AM 3 right to do formal interviews -- formal under oath
11:32:34AM 4 interviews.

11:32:35AM 5 Once resolution talks broke down and we had not
11:32:38AM 6 narrowed issues, then we knew exactly what was open, what
11:32:41AM 7 issues we thought we had to develop. And at that point in
11:32:44AM 8 time we thought, "Is it worth investing the energy now on
11:32:49AM 9 our part and on Microsoft's?" And the answer was clearly
11:32:52AM 10 yes. This is a huge issue. We needed to know what their
11:32:54AM 11 businesspeople thought of their various competitive
11:32:58AM 12 advantages, the things that are at issue in the valuation.

11:33:00AM 13 And we had not yet talked to the KPMG people on the
11:33:05AM 14 record, or the internal tax folks on the record, and we
11:33:08AM 15 asked to at the appropriate time, which is when Microsoft
11:33:11AM 16 told us that they did not want to narrow any issues, and
11:33:15AM 17 that we basically had to develop every open issue. And
11:33:19AM 18 the way to do that with witnesses is to get them on the
11:33:21AM 19 record.

11:33:23AM 20 Q. Well, focusing on Microsoft, this audit that began in
11:33:29AM 21 2007. From 2007, 2008, 2009, 2010, 2011, 2012, 2013, all
11:33:42AM 22 the way up until Quinn Emanuel got on the scene, had you
11:33:50AM 23 ever had a single one of the interviews where people were
11:33:55AM 24 put under oath and a court reporter transcribed the
11:34:00AM 25 questions and answers?

11:34:00AM 1 A. Yes, we did. I think we had two to three interviews
11:34:04AM 2 under oath in the aQuantive acquisition that we were
11:34:09AM 3 auditing for Microsoft. Those occurred prior to the
11:34:12AM 4 September and October interviews that took place in this
11:34:14AM 5 case.

11:34:14AM 6 Q. I am talking now about the transfer pricing audit
11:34:17AM 7 that you were doing. Is that what you are talking about?

11:34:20AM 8 A. That was a transfer pricing issue. It was in the
11:34:24AM 9 07/09 cycle. That interview occurred on a transfer
11:34:28AM 10 pricing issue, under oath, with several Microsoft current
11:34:31AM 11 or former employees.

11:34:32AM 12 Q. So now you are talking about a different audit for
11:34:34AM 13 different tax years, right?

11:34:34AM 14 A. Well, it is related to this one in part, because --

11:34:36AM 15 Q. Are you talking about a different audit for different
11:34:38AM 16 tax years?

11:34:39AM 17 MR. WEAVER: Objection, your Honor.

11:34:40AM 18 MR. BECK: Your Honor, we are never going to get
11:34:42AM 19 done today if I get ten minute answers for yes or no
11:34:45AM 20 questions.

11:34:48AM 21 THE COURT: Mr. Hoory, I need you to do your best
11:34:50AM 22 to answer his questions in a much shorter fashion.

11:34:54AM 23 THE WITNESS: I will do my best, your Honor.

11:34:57AM 24 THE COURT: Ask him another question, counsel.

11:35:01AM 25 By Mr. Beck:

11:35:01AM 1 Q. Were you just talking about a different audit for
11:35:03AM 2 different tax years?

11:35:04AM 3 A. I was talking about the 07/09 audit. It has
11:35:07AM 4 overlapping transfer pricing issues with the 04/06 audit.

11:35:11AM 5 Q. Different audit, different tax years, right?

11:35:13AM 6 A. Related audit, different tax years.

11:35:15AM 7 Q. Now, in the audit that we have been talking about, in
11:35:20AM 8 all these years, '07, '08, '09, '10, '11, '12, '13, and
11:35:28AM 9 the audit that is the subject of this litigation, before
11:35:31AM 10 Quinn Emanuel got involved, had you ever conducted an
11:35:36AM 11 interview where somebody was put under oath and a
11:35:39AM 12 transcript was made of the questions and answers?

11:35:41AM 13 A. I am not aware of an interview under oath in the
11:35:45AM 14 04/06 cycle prior to the ones in September and October.

11:35:53AM 15 Q. I think you said that things changed and you decided
11:36:01AM 16 that you wanted people under oath, and I wrote down your
11:36:05AM 17 words, and I am quoting here, "once resolution talks broke
11:36:09AM 18 down." As I understand it, sir, once it became clear that
11:36:17AM 19 you weren't going to be able to resolve this by agreement,
11:36:22AM 20 and that you were headed to the tax court, that's when you
11:36:27AM 21 and Quinn Emanuel decided that interviews ought to be
11:36:33AM 22 under oath and transcribed, right?

11:36:35AM 23 A. That's incorrect. Quinn Emanuel did not make the
11:36:39AM 24 decision, the IRS did.

11:36:40AM 25 Q. So we will take -- Well, did you talk to Quinn

1 Emanuel about it?

2 A. Not about the decision to seek interviews at that
3 time. So I communicated, I believe in February --

4 Q. I am talking about the decision that the interviews
5 that took place -- The first time you had people under
6 oath and transcribed it was in the fall of 2014, right?

7 A. Yes. But the decision to seek under oath interviews
8 was made long before that.

9 Q. And are you saying that before those interviews took
10 place, you never had any conversations with Quinn Emanuel
11 about whether people ought to be put under oath and the
12 questions and answers ought to be transcribed?

13 A. I don't recall ever discussing whether or not they
14 should be transcribed. What I recall, and you can see
15 references in the contract, that we anticipated, long
16 before Quinn Emanuel did any substantive work, that we may
17 want to do interviews, and that if we did, we may want
18 them to be present, just like we would with any expert
19 that we hire.

20 Q. In any event, whoever made the decision, and whoever
21 you consulted with, your testimony was that you decided
22 you wanted under oath transcripts once resolution talks
23 broke down, right?

24 A. We identified the need prior to that, but we wanted
25 to make sure we only ask for interviews in areas that

11:38:07AM 1 continue to remain open. Resolution could have narrowed
11:38:10AM 2 the areas, and it could have limited the topics that we
11:38:13AM 3 needed to interview people on. Once resolution talks
11:38:16AM 4 broke down entirely -- Which the first time that
11:38:20AM 5 Microsoft told us unequivocally that they didn't want to
11:38:23AM 6 talk to us anymore was in July. Up until that time there
11:38:26AM 7 were still some topics that were on the table that could
11:38:29AM 8 have been resolved. Once that happened, we had to do a,
11:38:32AM 9 "Look, what are all the open questions? What are open
11:38:34AM 10 topics? Who do we need to talk to to get to the right
11:38:38AM 11 number?"

11:38:38AM 12 Q. So it was after the resolution talks irrevocably
11:38:44AM 13 broke down, which you say was July, that's when you made
11:38:47AM 14 the decision "Now we need to make these under oath and
11:38:54AM 15 transcribed"?

11:38:55AM 16 MR. WEAVER: Objection. Mischaracterizes --

11:38:56AM 17 THE COURT: I think he answered that. The
11:38:58AM 18 objection will be sustained.

11:38:59AM 19 MR. BECK: Well, we apparently heard it
11:39:01AM 20 differently, because I thought the answer was yes, and he
11:39:03AM 21 said I mischaracterized it.

11:39:07AM 22 THE COURT: What he answered, according to our
11:39:10AM 23 transcript, was that the decision had been made earlier.
11:39:15AM 24 Once resolution talks broke down, that narrowed the areas
11:39:21AM 25 in terms of what they needed to actually focus on, but the

11:39:25AM 1 decision to do interviews, and do those under oath, had
11:39:27AM 2 been made earlier. That's what I understood Mr. Hoory to
11:39:31AM 3 have said.

11:39:32AM 4 Mr. Beck:

11:39:33AM 5 Q. Is that your sworn testimony, that before --

11:39:34AM 6 A. Let me clarify clearly, because I think it is a
11:39:37AM 7 little in between the two. The decision that if we had
11:39:39AM 8 unresolved issues, that we would have to pursue
11:39:41AM 9 interviews, and ask which ones to interview and that they
11:39:44AM 10 would be under oath, that was something that was on the
11:39:46AM 11 table that we discussed with the company long before we
11:39:49AM 12 actually asked for the interviewees. And that was long
11:39:52AM 13 before July, when they said, "We are not interested in
11:39:55AM 14 talking with you on any subjects whatsoever."

11:39:57AM 15 So when I say there was a decision to pursue under
11:39:59AM 16 oath interviews on any topics that were material, and that
11:40:08AM 17 we were not resolved, that concept, that goal existed and
11:40:13AM 18 was shared with the company. Certainly I told Mr. Bernard
11:40:16AM 19 the possibility way back in 2012. But certainly in
11:40:20AM 20 February, when Mr. Sample initially said he didn't want to
11:40:23AM 21 engage in all issues, and then certainly throughout the
11:40:25AM 22 spring when we were still trying to figure out what we
11:40:28AM 23 could still talk about.

11:40:29AM 24 Once they said, "We don't want to talk about
11:40:31AM 25 anything," that's when it made sense for us to shift gears

11:40:35AM 1 from trying to resolve one or more open topics and say,
11:40:38AM 2 "Okay, well, we have this whole bucket of topics that we
11:40:41AM 3 identified in January. You don't want to talk about any
11:40:43AM 4 of them, so now we have to go out and do interviews." And
11:40:46AM 5 just like we told the company consistently through the
11:40:49AM 6 spring on all those unresolved items, we anticipated
11:40:52AM 7 that if we identified people that could speak to them,
11:40:54AM 8 that they would be under oath.

11:40:56AM 9 Q. And one of your goals in putting people under oath
11:41:00AM 10 and having the testimony transcribed in the fall of 2014,
11:41:06AM 11 after the resolution talks had broken down, was to create
11:41:10AM 12 a record that Quinn Emanuel could use in the tax court,
11:41:13AM 13 right?

11:41:14AM 14 A. Our goal was to create a record that would reliably
11:41:19AM 15 document the facts upon which we based the decision we
11:41:21AM 16 were still working on to get to the right number.
11:41:24AM 17 Obviously that record would help if the case went to tax
11:41:28AM 18 court.

11:41:29AM 19 Q. Now, are you aware, just as a factual matter, whether
11:41:35AM 20 the tax court routinely allows pretrial discovery?

11:41:42AM 21 A. I am not.

11:41:45AM 22 Q. You don't know one way or another whether it is hard
11:41:48AM 23 to get discovery in the tax court?

11:41:51AM 24 A. I don't have any --

11:41:53AM 25 MR. WEAVER: Asked and answered.

11:41:54AM 1 THE COURT: I think he answered it, counsel.

11:41:56AM 2 Mr. Beck:

11:41:57AM 3 Q. Are you familiar with the tax court rules?

11:41:59AM 4 A. I have never litigated in tax court, no.

11:42:02AM 5 Q. Have you ever talked with anybody at the IRS about
11:42:06AM 6 how difficult it is to get discovery in the tax court?

11:42:13AM 7 A. To the extent I have talked about tax court
11:42:17AM 8 procedure, it has been seeking legal advice from IRS
11:42:22AM 9 counsel.

11:42:22AM 10 Q. I want to talk about the temporary regulation, which
11:42:55AM 11 I think you agreed you told Microsoft was the authority
11:42:57AM 12 for Quinn Emanuel and others to take testimony -- sworn
11:43:06AM 13 testimony in these interviews. Because it was a temporary
11:43:16AM 14 regulation rather than a final regulation, were you able
11:43:22AM 15 to pass this or adopt it without the kind of notice and
11:43:27AM 16 comment period that normally would be required?

11:43:30AM 17 MR. WEAVER: Objection, your Honor. This gets
11:43:31AM 18 into regulatory procedure. Mr. Hoory is not here as any
11:43:37AM 19 sort of regulatory expert. The question isn't directed to
11:43:41AM 20 his experience in the Microsoft audit.

11:43:44AM 21 MR. BECK: Your Honor, we are the ones who asked
11:43:46AM 22 him to come here. They didn't decide what the scope of
11:43:48AM 23 his testimony would be. He was involved in decisions
11:43:54AM 24 concerning the adoption of this temporary regulation, and
11:44:00AM 25 whether that was abusive or legitimate is one of the

11:44:05AM 1 issues in the case. I am asking him factual questions.

11:44:08AM 2 THE COURT: You are not asking him as an expert,
11:44:11AM 3 you're asking him --

11:44:11AM 4 MR. BECK: Yeah, I am asking him factual
11:44:13AM 5 questions.

11:44:13AM 6 THE COURT: The objection will be overruled. Why
11:44:15AM 7 don't you rephrase the question for Mr. Hoory?

11:44:17AM 8 MR. BECK: Sure.

11:44:18AM 9 By Mr. Beck:

11:44:19AM 10 Q. What you understood in your role there at the
11:44:26AM 11 transfer pricing organization is that one effect of
11:44:34AM 12 adopting a temporary regulation instead of a final
11:44:38AM 13 regulation is that you didn't have to give notice to the
11:44:43AM 14 public and give people an opportunity to comment before it
11:44:47AM 15 went into effect, right?

11:44:49AM 16 A. Let me be clear. I didn't -- I certainly don't
11:44:53AM 17 recall having any conversations about what kind of
11:44:56AM 18 regulation was going to be issued. To the extent I had
11:45:01AM 19 involvement with the reg, it was an opportunity to provide
11:45:06AM 20 comments on the substantive wording, not the procedural
11:45:10AM 21 pieces.

11:45:10AM 22 Q. You didn't know that it was going to be a temporary
11:45:13AM 23 regulation?

11:45:14AM 24 A. I don't recall focusing on that particular issue. It
11:45:17AM 25 is possible that I may have noticed that it had a T next

11:45:20AM 1 to it at some point in time. But that was not an issue
11:45:23AM 2 that I focused on personally.

11:45:24AM 3 Q. Well, if it didn't have a T next to it, you wouldn't
11:45:28AM 4 have been able to rely on it when you wrote Microsoft and
11:45:31AM 5 said, "Here is the justification for Quinn Emanuel to be
11:45:36AM 6 participating in these sworn depositions," right?

11:45:40AM 7 A. I honestly don't know. I am not an expert. And I
11:45:44AM 8 don't specialize in the process of promulgating
11:45:48AM 9 regulations.

11:45:49AM 10 Q. You don't know the difference between a temporary and
11:45:52AM 11 a final regulation?

11:45:53AM 12 A. One of the differences I do know, as an example, is I
11:45:56AM 13 think temporary regs expire in two years. But I don't
11:46:01AM 14 know exactly what the differences are between a -- I know
11:46:06AM 15 a regulation is permanent and a temporary regulation is
11:46:10AM 16 temporary. I know there are different procedures. I
11:46:13AM 17 don't know what they are. I haven't had a reason in my
11:46:15AM 18 practice to research the difference between the two. I
11:46:17AM 19 don't know.

11:46:17AM 20 Q. And your sworn testimony is you don't know that when
11:46:22AM 21 there is a temporary regulation that is adopted, the IRS
11:46:29AM 22 doesn't have to follow the normal notice and comment
11:46:32AM 23 procedures? That's your sworn testimony?

11:46:36AM 24 MR. WEAVER: Asked and answered, your Honor.

11:46:37AM 25 THE COURT: The objection will be sustained. Next

11:46:40AM 1 question, Mr. Beck.

11:46:42AM 2 By Mr. Beck:

11:46:43AM 3 Q. If we get discovery and we can talk to people at the
11:46:46AM 4 IRS, is there anybody, other than getting legal advice,
11:46:50AM 5 that you have ever talked to about this temporary
11:46:57AM 6 regulation?

11:46:57AM 7 A. I think there is one of the exhibits that I am
11:47:03AM 8 familiar with that you will see I provided some comments
11:47:05AM 9 on a green sheet circulation. Certainly therein you will
11:47:08AM 10 see the persons to whom I sent those comments. If I
11:47:14AM 11 recall correctly, there was Howard Berger and Tom Ralph.
11:47:19AM 12 They are colleagues of mine in the transfer pricing
11:47:23AM 13 practice or in the TPO. One is in TPO, one is in transfer
11:47:26AM 14 pricing practice, or TPP. They are the persons, it is my
11:47:31AM 15 understanding that -- their case is that the reg project
11:47:35AM 16 originated from, at least of the need for it originated
11:47:37AM 17 from. I think on that email chain was Sam Maruca, my
11:47:43AM 18 boss, who was obviously interested in the use of experts.
11:47:43AM 19 And Tom Vidano is the other person I recall.

11:47:47AM 20 Q. And those are names on an email chain. My question
11:47:50AM 21 is, did you talk to them orally or anybody else at the IRS
11:47:56AM 22 orally about this temporary regulation?

11:47:59AM 23 A. Yes.

11:48:00AM 24 Q. Who?

11:48:00AM 25 A. Those same people.

11:48:03AM 1 Q. You talked to them, had conversations with them about
11:48:06AM 2 the temporary regulation?

11:48:08AM 3 A. I remember having conversations with them after the
11:48:12AM 4 reg was issued. Because -- When the green sheet got
11:48:16AM 5 circulated, I don't recall actually discussing it with
11:48:18AM 6 them. I recall sending and exchanging email
11:48:22AM 7 communications.

11:48:22AM 8 Q. When did you first become aware that this temporary
11:48:25AM 9 regulation was in the works?

11:48:27AM 10 A. I did not learn that the temporary project had
11:48:34AM 11 started or that a reg project had started, because I
11:48:38AM 12 didn't know what variety it was at the time. So I didn't
11:48:40AM 13 learn about the reg project, to the best of my
11:48:43AM 14 recollection, until sometime in the spring of 2014. I had
11:48:47AM 15 previously, in 2013, learned about the issue -- just the
11:48:52AM 16 issue about whether experts could participate or not in
11:48:57AM 17 summons interviews, because Mr. Ralph and Mr. Berger had
11:49:01AM 18 brought it to my attention when it arose in their case.
11:49:04AM 19 But at that point in time, to the best of my knowledge,
11:49:06AM 20 there was no reg project.

11:49:08AM 21 I learned about the issue that the reg was addressing
11:49:11AM 22 and clarifying in 2013. I don't recall learning about --
11:49:16AM 23 that a reg project had started until sometime in 2014.

11:49:19AM 24 Q. Tell me what they told you in 2013 about how this
11:49:22AM 25 issue had arisen. What did they tell you?

11:49:26AM 1 A. So Tom Ralph, he was the central manager for the
11:49:31AM 2 transfer pricing practice. He has a large, I guess -- not
11:49:36AM 3 docket, but number of cases that he supports in transfer
11:49:40AM 4 pricing. Howard Berger. He was a colleague of mine in
11:49:44AM 5 the transfer pricing operation. Just like I do, he
11:49:48AM 6 supported local teams. In this case he was supporting
11:49:50AM 7 Mr. Ralph's. There, my understanding is, from
11:49:52AM 8 conversations with them, that they had an outside expert.
11:49:57AM 9 I don't know the exact variety, but my impression was that
11:50:02AM 10 it was an economist. And whatever variety of expert it
11:50:06AM 11 was, they had wanted to schedule some interviews with the
11:50:10AM 12 taxpayer, to speak to taxpayer employees, just like we are
11:50:15AM 13 trying to do in the Microsoft case a couple of years
11:50:18AM 14 later.

11:50:20AM 15 When they said that their expert would be there, the
11:50:24AM 16 taxpayer objected. At that point in time Mr. Ralph and
11:50:28AM 17 Mr. Berger reached out to their colleagues in transfer
11:50:31AM 18 pricing, so I can remember them reaching out to myself,
11:50:35AM 19 Mr. Maruca, and said, "Hey, we have never seen this. Have
11:50:39AM 20 you seen this?" In our collective experience -- not so
11:50:42AM 21 much me, but if you add my colleagues' experience
11:50:45AM 22 together, that is multiple decades. Between the four of
11:50:48AM 23 us we probably have about 80 years. We were all
11:50:50AM 24 flabbergasted and surprised. We thought that is a
11:50:53AM 25 creative argument, but one no one ever expected. At least

11:50:56AM 1 from our perspectives, we had always assumed that the IRS,
11:51:00AM 2 when it hired experts, that they could ask questions; and
11:51:02AM 3 if those questions are in the format of a summons
11:51:06AM 4 interview, that there was no issue, just like we share
11:51:08AM 5 with experts documents day in and day out so they can
11:51:11AM 6 assist us with their analyses.

11:51:13AM 7 Q. This interview that they told you about, was this an
11:51:17AM 8 interview where a witness was put under oath and the
11:51:20AM 9 questions and answers were transcribed?

11:51:23AM 10 A. It is my understanding that is what they were
11:51:26AM 11 seeking, that's correct.

11:51:27AM 12 Q. And then was your understanding that this entire
11:51:31AM 13 temporary regulation project was geared toward creating
11:51:37AM 14 some authority that you could rely on for allowing outside
11:51:43AM 15 experts or contractors to participate in sworn interviews?

11:51:52AM 16 A. I wouldn't characterize it that way. It is close,
11:51:55AM 17 but not exact. It is my understanding that that initial
11:51:58AM 18 identification of this issue, which surprised all of us,
11:52:02AM 19 didn't make sense to the IRS, and wasn't consistent with
11:52:05AM 20 our understanding of how we could and do use experts.

11:52:08AM 21 And that at some point in time -- and there was a long
11:52:11AM 22 period of time where I didn't hear anything about it, but
11:52:13AM 23 at some point in time someone was presumably working on
11:52:16AM 24 this or thinking about this. At some point in time in
11:52:19AM 25 2014 I became aware of this reg project, to clarify and

11:52:23AM 1 make clear what the IRS thought and what its position was
11:52:26AM 2 at the time, that our experts are there to help us, they
11:52:29AM 3 are there to look at books and records, and when we do
11:52:32AM 4 interviews they are there to help us ask intelligent
11:52:35AM 5 questions. We wanted to make sure they were able to do
11:52:38AM 6 so.

11:52:38AM 7 Q. In your collective 70 or 80 years of experience,
11:52:41AM 8 whatever it was that you mentioned before, had any of you
11:52:48AM 9 ever been involved in a situation where instead of an
11:52:52AM 10 economist or an engineer or an accountant, some sort of
11:52:59AM 11 expert like that, instead of that the IRS had hired
11:53:04AM 12 outside counsel to act as consultants, and for the outside
11:53:13AM 13 counsel to be asking questions of witnesses when they are
11:53:19AM 14 under oath and being transcribed?

11:53:22AM 15 A. I can't speak to my colleagues' experience --

11:53:26AM 16 Q. Just yours then.

11:53:27AM 17 A. My own. I am aware of cases where the IRS has hired
11:53:32AM 18 outside counsel to advise. I am not aware of cases where
11:53:34AM 19 they have invited counsel to do under-oath interviews.

11:53:39AM 20 Q. So far as you know, nobody else had ever done that,
11:53:44AM 21 right?

11:53:45AM 22 A. As far as I know, with respect to the outside
11:53:49AM 23 counsel.

11:53:49AM 24 Q. Right, right, the outside counsel. As far as you
11:53:52AM 25 know, the first time in the history of the universe that

11:53:55AM 1 anybody from the IRS said that outside counsel should be
11:54:02AM 2 allowed to participate as experts or contractors in
11:54:08AM 3 conducting sworn testimony, the first time in the history
11:54:11AM 4 of the universe was when you did it with Quinn Emanuel in
11:54:17AM 5 the fall of 2014, right?

11:54:19AM 6 A. That is the first instance that I am aware of. I
11:54:22AM 7 guess I am a trailblazer.

11:54:24AM 8 Q. And planning to do this, and be this trailblazer, you
11:54:37AM 9 say you weren't tracking closely what was going on with
11:54:40AM 10 this regulation project?

11:54:42AM 11 A. Give me one moment, please. I wasn't aware of the
11:54:52AM 12 reg project until the spring of 2014, as I mentioned. I
11:54:56AM 13 don't know when it started.

11:54:58AM 14 Q. I would like to shift gears here to what was
11:55:22AM 15 happening during the audit.

11:55:24AM 16 THE COURT: Counsel, if we are going to shift
11:55:27AM 17 gears here, we are about five minutes before noon, let's
11:55:30AM 18 go ahead and break for our noon recess. If we could have
11:55:33AM 19 everybody back at ten minutes after 1:00, and then we will
11:55:37AM 20 do our best to start up at 1:15, and hopefully have
11:55:41AM 21 everybody here. We will be in recess.

01:15:05PM 22 (Lunch break.)

01:15:05PM 23 THE COURT: Counsel, before we get started, I am a
01:15:08PM 24 little bit concerned about the pacing of how we are going
01:15:11PM 25 today. Mr. Weaver, let me ask you, how much time does the

01:15:14PM 1 IRS feel that they need for their presentation?

01:15:18PM 2 MR. WEAVER: Your Honor, I appreciate that. We
01:15:20PM 3 are going to need an hour and 15 minutes to an hour and a
01:15:23PM 4 half to lay out what I laid out in my opening. We need
01:15:27PM 5 that much time.

01:15:28PM 6 THE COURT: Mr. Beck, what that means is, we have
01:15:30PM 7 about two and a half hours left in the afternoon, once we
01:15:33PM 8 factor in our break for our court reporter. You have
01:15:37PM 9 about an hour, counsel.

01:15:39PM 10 MR. BECK: Thank you, sir. I would just ask if
01:15:44PM 11 perhaps the court could request Mr. Hoory, once again, to
01:15:47PM 12 try to keep his answers short and responsive. That would
01:15:51PM 13 help me get through as much as I can.

01:15:53PM 14 THE COURT: Mr. Hoory, I would ask -- and I have
01:15:56PM 15 asked this before, just do your best to answer the
01:15:59PM 16 question. All of the legal arguments will be made at a
01:16:03PM 17 later point in time. The interpretations of statutes will
01:16:07PM 18 be something the court does. So from you we just need the
01:16:11PM 19 facts. All right?

01:16:12PM 20 THE WITNESS: I understand, your Honor.

01:16:14PM 21 THE COURT: You may inquire.

01:16:16PM 22 By Mr. Beck:

01:16:16PM 23 Q. Mr. Hoory, I think you mentioned before the break
01:16:19PM 24 that you commented at some point on the temporary
01:16:24PM 25 regulation?

01:16:26PM 1 A. I commented on the green sheet circulation. It
01:16:30PM 2 wasn't a temp reg -- Are you talking about before or
01:16:33PM 3 after, is what I am asking?

01:16:35PM 4 Q. Did you ever comment on what became the temporary
01:16:38PM 5 regulation?

01:16:39PM 6 A. I discussed the regs after they were promulgated,
01:16:43PM 7 yes.

01:16:44PM 8 Q. Didn't you comment before the regulation was adopted?

01:16:50PM 9 A. If you mean the input I had into the language, that
01:16:55PM 10 was obviously before it was adopted. If you mean have I
01:16:57PM 11 ever mentioned the regulation after it was adopted,
01:17:00PM 12 obviously I have.

01:17:01PM 13 Q. No, no, no. You had input before the regulation was
01:17:05PM 14 adopted, and you wrote a comment, right?

01:17:07PM 15 A. Correct.

01:17:08PM 16 Q. Now, I want to show you Exhibit 130. This is what
01:17:20PM 17 was produced to us in response to our FOIA request. On
01:17:28PM 18 here somewhere is there an email that is your -- transmits
01:17:34PM 19 your comment?

01:17:35PM 20 A. I think you will have to scroll down a page or two,
01:17:37PM 21 if this is the email that I am aware of.

01:17:41PM 22 Q. Here we go, on Page 2. What we got in response to
01:17:49PM 23 our FOIA request was from Eli Hoory to various people,
01:17:59PM 24 "Re: Green sheet circulation." And I don't want to spend
01:18:02PM 25 the time to talk about the green sheet, what that means

01:18:05PM 1 exactly, but it is an opportunity for you to comment
01:18:09PM 2 before a regulation is promulgated, right?

01:18:12PM 3 A. That's right. In a fairly late stage, yes.

01:18:15PM 4 Q. And the question -- the subject that you wrote is,
01:18:22PM 5 "7602." Again, without getting into the substance, that
01:18:27PM 6 is the statutory provision that says that the secretary or
01:18:31PM 7 the secretary's delegates are allowed to take sworn
01:18:35PM 8 testimony, right?

01:18:36PM 9 A. Right. But I didn't write that subject. I just
01:18:39PM 10 replied to an email.

01:18:41PM 11 Q. You were replying to an email saying that. And the
01:18:45PM 12 email says, "Urgent." And then this "importance high,"
01:18:50PM 13 was that something that you put on there or was that sent
01:18:54PM 14 to you?

01:18:54PM 15 A. I don't recall. I can't tell you that every green
01:18:59PM 16 sheet I have ever received says "urgent" next to it.
01:19:02PM 17 Depending upon what your settings are -- sometimes we
01:19:04PM 18 applied them -- I don't know if it was me or them,
01:19:05PM 19 honestly.

01:19:06PM 20 Q. Then what we were given was, "Tom," and then
01:19:12PM 21 everything else is blacked out?

01:19:14PM 22 A. Up to, "Thanks for your consideration," yes.

01:19:15PM 23 Q. I'm sorry? What?

01:19:17PM 24 A. Yes. Up to the bottom, yes.

01:19:19PM 25 Q. I guess there is something that says "thanks" or

01:19:22PM 1 something at the bottom. I can't read that part.

01:19:25PM 2 Did you have anything to do with the decision to
01:19:31PM 3 black out your email?

01:19:33PM 4 A. I did not.

01:19:33PM 5 Q. So then recently -- Let me show you Exhibit 130-1.
01:19:53PM 6 So recently somebody made a decision to unredact this
01:19:59PM 7 email and to produce it to us in connection with this
01:20:04PM 8 lawsuit. Have you seen this unredacted version in the
01:20:08PM 9 last couple of weeks?

01:20:09PM 10 A. I have. I saw it this week.

01:20:11PM 11 Q. In connection with preparing for your testimony,
01:20:14PM 12 right?

01:20:15PM 13 A. Correct.

01:20:16PM 14 Q. Did you have any role in deciding, notwithstanding
01:20:25PM 15 the claim of deliberative process, that the IRS was going
01:20:28PM 16 to waive deliberative process when it came to your
01:20:31PM 17 comments on the regulation?

01:20:33PM 18 A. I'm not sure if I can answer the back and forth of
01:20:39PM 19 counsel.

01:20:39PM 20 THE COURT: Do you understand the question?

01:20:41PM 21 THE WITNESS: I understand the question. I will
01:20:42PM 22 ask --

01:20:43PM 23 MR. WEAVER: To the extent that there was any
01:20:45PM 24 discussion with counsel, we are asserting privilege.

01:20:49PM 25 THE COURT: You are just looking -- Let me have

01:20:52PM 1 you ask for a specific --

01:20:55PM 2 MR. BECK: I am not asking for the substance of
01:20:57PM 3 any conversations that he had with counsel. I am asking
01:21:00PM 4 whether he had any role in the decision to waive the
01:21:05PM 5 deliberative process privilege insofar as it related to
01:21:09PM 6 his comments on this regulation.

01:21:15PM 7 THE COURT: You can answer yes or no.

01:21:16PM 8 THE WITNESS: Basically, yes. I did interpret the
01:21:20PM 9 deliberative process or how it applied, but I commented on
01:21:25PM 10 whether it made sense to unredact or redact.

01:21:28PM 11 By Mr. Beck:

01:21:28PM 12 Q. You wanted this unredacted?

01:21:29PM 13 A. I was in favor of it, personally.

01:21:32PM 14 Q. You thought if you waived the deliberative process as
01:21:37PM 15 to this particular document, that would help the IRS's
01:21:40PM 16 case, right?

01:21:42PM 17 A. I thought it would allow you and the court to see
01:21:44PM 18 what I wrote and assess the content.

01:21:47PM 19 Q. And you thought it would help the IRS's cause if you
01:21:52PM 20 waived the deliberative process as to your comments, even
01:21:57PM 21 though they are maintaining it as to everybody else's,
01:22:00PM 22 right?

01:22:00PM 23 A. I honestly don't know whether it would help or not.
01:22:04PM 24 I think it gives the court information that they wouldn't
01:22:06PM 25 have otherwise had. If it is helpful for us, it helps us.

01:22:10PM 1 If the court determines it is not, it is not going to help
01:22:13PM 2 us. I thought it made sense to lay it out and let the
01:22:16PM 3 court decide.

01:22:17PM 4 Q. Is there some reason why it makes sense to lay it all
01:22:22PM 5 out and let the court decide based on all the facts when
01:22:27PM 6 it comes to your comments, but not as to everybody else's?

01:22:32PM 7 A. I don't know what other persons' comments are, so I
01:22:34PM 8 can't really evaluate that.

01:22:36PM 9 Q. Well, if you think that the right thing to do is to
01:22:40PM 10 let the chips fall where they may, whether it is helpful
01:22:43PM 11 or not helpful, just so the judge has all the information
01:22:47PM 12 as to your comments, wouldn't that apply as to everybody
01:22:51PM 13 else's comments?

01:22:53PM 14 A. I imagine it depends upon the content and whether it
01:22:56PM 15 is covered by privilege.

01:22:57PM 16 Q. Well, yours were covered by privilege, but you said
01:23:00PM 17 you wanted it unredacted so the judge would have the full
01:23:04PM 18 story, right?

01:23:05PM 19 A. This is something I wrote -- To the extent I made
01:23:11PM 20 some comments and they are relevant to the matters at
01:23:15PM 21 issue, I would like to know whether or not they are
01:23:18PM 22 helpful or hurtful. You know, just get it out of the way
01:23:20PM 23 and I can move on with my life and the examination. Yes,
01:23:24PM 24 I wanted them out.

01:23:31PM 25 Q. Now, in your comments over on Page 2, where we see

01:23:41PM 1 the unredacted version -- And I am going to try to see if
01:23:48PM 2 I can summarize and shorten it up a little bit. As I
01:23:52PM 3 understand the substance of your comment, you were
01:23:55PM 4 suggesting that a dependent clause be moved within the
01:24:00PM 5 language of the regulation, because as it was written
01:24:04PM 6 somebody could interpret it to mean that experts couldn't
01:24:10PM 7 even look at documents unless they were under the
01:24:13PM 8 supervision of the -- direct supervision of the IRS, and
01:24:18PM 9 you wanted to make sure that clause removed -- was moved
01:24:24PM 10 so that people understood that experts could look at
01:24:27PM 11 documents on their own, but they couldn't take testimony
01:24:31PM 12 unless they were under the supervision of the IRS?

01:24:34PM 13 A. Yeah, that is basically it. I was supporting what we
01:24:37PM 14 understood the status quo to be.

01:24:39PM 15 Q. And, of course, one of the experts you had in mind
01:24:42PM 16 that would be covered by this was Quinn Emanuel, right?

01:24:45PM 17 A. Together with every other expert --

01:24:48PM 18 Q. I said one of the experts was Quinn Emanuel, right?

01:24:51PM 19 A. Yes, together with every other expert the IRS hires.

01:24:54PM 20 Q. You didn't want anybody to think that when Quinn
01:24:57PM 21 Emanuel is going over our confidential taxpayer
01:24:59PM 22 information, that they should have to be under the
01:25:02PM 23 supervision of the IRS, right?

01:25:04PM 24 A. I didn't think they would have to be in the presence
01:25:07PM 25 of the IRS. Obviously, they are always working for us,

01:25:10PM 1 and they are always supervised by a COR, contracting
01:25:15PM 2 officer's representative, and the POC, the point of
01:25:17PM 3 contract, or a contracting officer. So I didn't think we
01:25:20PM 4 needed to be physically present when they were looking at
01:25:24PM 5 documents.

01:25:25PM 6 Q. In fact, you gave them, didn't you, computers that
01:25:29PM 7 had like all of our documents on them? And you gave Quinn
01:25:32PM 8 Emanuel special computers that were loaded up with all of
01:25:35PM 9 the confidential information that we turned over over
01:25:39PM 10 eight years in this audit process, right?

01:25:41PM 11 A. That is actually inaccurate. We gave them laptops at
01:25:45PM 12 some point. I don't think we had anything preloaded on
01:25:48PM 13 them. The reason we gave them to them is because the IRS
01:25:51PM 14 computers allow for secure communications. So it was
01:25:54PM 15 actually to protect the information better, not vice
01:25:57PM 16 versa.

01:25:57PM 17 Q. Well, these computers, did they have access to the
01:26:01PM 18 servers where all of our confidential information is kept?

01:26:06PM 19 A. I honestly don't know.

01:26:08PM 20 Q. Well, how were they going to review all of our stuff
01:26:12PM 21 unless they had access to it on their computers?

01:26:14PM 22 A. We gave it to them on secure removable media
01:26:17PM 23 originally, encrypted in accordance with the Federal
01:26:19PM 24 Information Protection Standards.

01:26:19PM 25 Q. And then they put that stuff on their computers,

01:26:22PM 1 right?

01:26:22PM 2 A. Are you talking about the laptops? I don't know
01:26:25PM 3 where they put them, honestly.

01:26:27PM 4 Q. I want to focus actually not so much on your wanting
01:26:31PM 5 to move the clause around as -- introductory statement
01:26:38PM 6 here. I think you testified that this was the only time
01:26:45PM 7 you commented on the reg, right?

01:26:46PM 8 A. I didn't say that this was. I said this instance is
01:26:49PM 9 what I am talking about. What I am referring to here,
01:26:52PM 10 "One final comment," is there were some exchanges. There
01:26:55PM 11 is other people on this email, including Howard Berger and
01:26:59PM 12 Tom Ralph, who I referred to earlier. They had some
01:27:02PM 13 comments previously. I don't know if it was in this email
01:27:04PM 14 chain or a different one, because we could send things in
01:27:07PM 15 differently. In other words, you could get the same email
01:27:10PM 16 reply to it, and Mr. Weaver could reply to the same email
01:27:14PM 17 separately. What I was referring to in, "One more
01:27:18PM 18 comment" was Mr. Berger and Mr. Ralph had made some prior
01:27:22PM 19 comments, I was adding one additional one.

01:27:25PM 20 Q. You say, "One final comment/suggestion." You had no
01:27:31PM 21 idea somebody was going to comment after you?

01:27:33PM 22 A. I am speaking for myself. This is my last comment.

01:27:36PM 23 Q. Your last comment. What I want to know is -- Here
01:27:39PM 24 you have transmitted your last comment. I want to know
01:27:42PM 25 about your earlier comments.

01:27:44PM 1 A. So, as I mentioned, Mr. Berger and Mr. Ralph had some
01:27:49PM 2 comments previously. I do -- I don't recall -- I
01:27:52PM 3 remember Mr. Ralph's had to do with the effective date and
01:27:57PM 4 timing, and I remember Mr. Berger's was substantive,
01:28:03PM 5 something stylistic. I don't remember what they were.
01:28:04PM 6 The only thing I remember prior to this email was me
01:28:08PM 7 seconding Howard's suggestions as things that made sense.

01:28:12PM 8 Q. Where is that? We haven't seen any other emails from
01:28:15PM 9 you at all commenting on the regulation. You mean there
01:28:18PM 10 are other emails and we just haven't been given them?

01:28:21PM 11 A. I don't know what you have been given or not.

01:28:23PM 12 Q. I can represent to you that we don't have any other
01:28:25PM 13 emails from you commenting on --

01:28:27PM 14 A. I can tell you -- I don't know at what stage it was,
01:28:30PM 15 but I can tell you that I hit reply at some point with
01:28:35PM 16 regards to comments that either Mr. Ralph or Mr. Berger
01:28:39PM 17 made at some point with respect to this regulation.

01:28:42PM 18 Q. Would you agree --

01:28:43PM 19 A. I think it was all within like a day or two,
01:28:46PM 20 honestly. I don't know the exact time, though.

01:28:47PM 21 Q. Do you agree that wherever this email is, where you
01:28:52PM 22 hit reply, and then another comment, that we ought to be
01:28:57PM 23 able to look at that, too?

01:28:58PM 24 A. I honestly don't care one way or another. I will
01:29:02PM 25 leave that to IRS counsel to determine what is or isn't

01:29:05PM 1 privileged.

01:29:05PM 2 Q. Well, didn't you already decide that your comments --
01:29:14PM 3 you are going to waive the deliberative process privilege?
01:29:17PM 4 Are you saying you decided to --

01:29:19PM 5 A. I don't make the decision --

01:29:20PM 6 Q. -- waive it as to one, but not waive it as to others?

01:29:24PM 7 A. I don't make the decision on what gets waived and
01:29:26PM 8 what isn't.

01:29:27PM 9 Q. You participated in it, though? You just said so,
01:29:29PM 10 right?

01:29:29PM 11 A. Only with respect to this email.

01:29:30PM 12 Q. So you are saying, as far as you are concerned, you
01:29:34PM 13 wanted the judge to have the full story, but only as to
01:29:37PM 14 this email. For other emails from you, you want to leave
01:29:40PM 15 it up to counsel to decide, right?

01:29:42PM 16 A. At the end of the day, IRS counsel or the P&A folks,
01:29:47PM 17 they determine what is privileged or not. This is the one
01:29:49PM 18 we discussed, because my understanding is it is what made
01:29:53PM 19 it to the administrative file. Other things -- I don't
01:29:55PM 20 know what is in or out. I don't make those
01:29:58PM 21 determinations.

01:29:59PM 22 Q. I want to talk now about some things that happened
01:30:21PM 23 during the audit. You indicated, I think, that you joined
01:30:30PM 24 the TPO -- what was it, November of 2011?

01:30:34PM 25 A. I think it was October -- The first time I was

01:30:37PM 1 involved in the Microsoft audit was November.

01:30:41PM 2 Q. So within a month of joining the TPO. Did you come
01:30:45PM 3 directly from Covington & Burling?

01:30:47PM 4 A. I did.

01:30:48PM 5 Q. Within a month you were involved in the Microsoft
01:30:51PM 6 audit, right?

01:30:52PM 7 A. Initially at a very high level as an audience. Over
01:30:55PM 8 time I came to be more involved, yes.

01:30:58PM 9 Q. In fact, you not only became more involved, you are
01:31:01PM 10 in charge of the Microsoft audit now, right?

01:31:02PM 11 A. I wouldn't say that. I would say that I take the
01:31:05PM 12 lead with respect to the transfer pricing issues.

01:31:09PM 13 Q. Okay. Fine. The subject matter we have been
01:31:10PM 14 focusing on, transfer pricing issues, you have taken the
01:31:16PM 15 lead on that on behalf of the TPO, right?

01:31:18PM 16 A. Certainly.

01:31:19PM 17 Q. Now, does the TPO have a roadmap -- a general roadmap
01:31:26PM 18 that they follow in transfer pricing audits?

01:31:31PM 19 A. So as part of standing up TPO, they worked on,
01:31:35PM 20 basically, procedures. They are not one-size-fits-all.
01:31:42PM 21 There are some goals and things to think about. But, yes,
01:31:44PM 22 there was a roadmap that was developed. I think it was
01:31:47PM 23 published sometime in 2014.

01:31:48PM 24 Q. Is Exhibit 136 the roadmap?

01:31:51PM 25 A. Looks right to me.

01:31:53PM 1 Q. And the introductory paragraph here -- Did you have
01:32:01PM 2 input into this roadmap?

01:32:02PM 3 A. Very limited. There were other persons who worked on
01:32:06PM 4 that much closely than I did.

01:32:07PM 5 Q. But you are familiar with it, right?

01:32:09PM 6 A. Broadly. I reviewed it for today.

01:32:11PM 7 Q. I'm sorry?

01:32:11PM 8 A. I said I reviewed it to make sure I was up to speed
01:32:14PM 9 on it for today.

01:32:15PM 10 Q. You reviewed it at the time it came out, or in
01:32:19PM 11 preparation for your testimony?

01:32:20PM 12 A. I reviewed it in preparation for my testimony. At
01:32:24PM 13 the time it came out I had seen an earlier iteration,
01:32:29PM 14 maybe -- probably a year or two before it came out, but I
01:32:33PM 15 wasn't involved at the time it actually got published.

01:32:34PM 16 Q. Okay. But you are up to speed on it for your
01:32:38PM 17 testimony, right?

01:32:38PM 18 A. Certainly.

01:32:39PM 19 Q. So we have this introductory language here. I want
01:32:45PM 20 to move as quickly as I can and focus on the kind of
01:32:52PM 21 time -- the generalized timeline that is on Page 3. And I
01:32:56PM 22 have highlighted here, "Transfer pricing audit stages and
01:33:00PM 23 timeline." And then you, you being the IRS, set forth
01:33:06PM 24 kind of a typical sequence and timeline for the different
01:33:10PM 25 stages of a transfer pricing audit, correct?

01:33:13PM 1 A. Yes. But on the first page it basically says there
01:33:17PM 2 is no one-size-fits-all. It says that transfer pricing
01:33:21PM 3 cases are very complex, fact specific, and they typically
01:33:23PM 4 take two to three years or more. So this is just a
01:33:27PM 5 generic sense.

01:33:27PM 6 Q. Along the way here, and in other parts of the
01:33:38PM 7 document, do you identify or the IRS identify who should
01:33:42PM 8 be involved at these different stages?

01:33:44PM 9 A. I think there is aspirational statements to that
01:33:47PM 10 effect, yes.

01:33:48PM 11 Q. Is there any place in this document that you are up
01:33:52PM 12 to speed on where the IRS says, "Here is the point where
01:33:57PM 13 we ought to bring in outside counsel to help us complete
01:34:04PM 14 the audit, or give us a gut check, or get ready to fight
01:34:09PM 15 in the tax court"?

01:34:10PM 16 A. I don't think -- It certainly doesn't use the words
01:34:15PM 17 you used.

01:34:15PM 18 Q. Well, is there any place anywhere in the document
01:34:18PM 19 that you are up to speed on where the IRS says, "Here is
01:34:24PM 20 the stage to bring in outside counsel, because they can be
01:34:28PM 21 so helpful in these complicated audits"?

01:34:32PM 22 A. It talks about who is supposed to be involved. It
01:34:34PM 23 doesn't use the words "outside counsel." It talks about
01:34:36PM 24 evaluating, once you know enough about the basic facts,
01:34:39PM 25 what kind of expertise you need. It talks about bringing

01:34:41PM 1 in internal folks to get up to speed. It talks about
01:34:44PM 2 consulting with IRS counsel. It also talks about
01:34:47PM 3 considering whether or not you should hire outside experts
01:34:49PM 4 as well.

01:34:51PM 5 Q. And you said what kind of expertise ought to be
01:34:55PM 6 involved. And nowhere in this document, that you are up
01:34:58PM 7 to speed on, does the IRS say, "You know what, one area of
01:35:04PM 8 expertise that is really important in these complicated
01:35:08PM 9 transfer pricing cases is commercial litigation
01:35:12PM 10 expertise," right?

01:35:13PM 11 A. It does not use those words anywhere in the document.

01:35:16PM 12 Q. It not only doesn't use those words, it doesn't have
01:35:20PM 13 that concept remotely referred to in the document, does
01:35:23PM 14 it?

01:35:23PM 15 A. This is a generic roadmap --

01:35:26PM 16 Q. And in this generic document --

01:35:27PM 17 THE COURT: Mr. Beck. I'm sorry. You have to
01:35:28PM 18 let --

01:35:29PM 19 By Mr. Beck:

01:35:29PM 20 Q. Go ahead. It is a generic document.

01:35:31PM 21 A. Well, it is a generic roadmap. Every case is
01:35:34PM 22 different. It says that clearly in here. You have to
01:35:37PM 23 consider the facts and circumstances in the case, because
01:35:38PM 24 that's what makes or breaks a transfer pricing audit. We
01:35:42PM 25 also talk about dropping things when we look at them, and

01:35:45PM 1 don't beat the bushes. If you find something, you decide
01:35:48PM 2 what resources you need. It is talking about making
01:35:50PM 3 intelligent decisions. In this case, given its size -- in
01:35:53PM 4 Microsoft's case, given its size and complexity, we
01:35:55PM 5 thought that complex commercial litigation expertise was
01:36:00PM 6 one thing that could add to our resources and make us get
01:36:02PM 7 to a better result, a more reasonable result, and the
01:36:05PM 8 right number.

01:36:05PM 9 Q. This is the kind of answer I was hoping you would
01:36:08PM 10 give me yes or no on. My question was, nowhere in this
01:36:11PM 11 document, that you are up to speed on, is there any hint
01:36:18PM 12 that outside lawyers should be hired, because one of the
01:36:21PM 13 areas of expertise that you claim is so important in an
01:36:25PM 14 audit is commercial litigation, right?

01:36:27PM 15 A. I already told you this does not refer to commercial
01:36:31PM 16 litigators, in my memory.

01:36:33PM 17 Q. Incidentally, Quinn Emanuel -- John Quinn and John
01:36:43PM 18 Gordon, did they have any tax experience in their
01:36:47PM 19 background?

01:36:48PM 20 A. I know that John Gordon has -- represents clients on
01:36:54PM 21 tax matters. I do not know with respect to Mr. Quinn.

01:36:58PM 22 Q. Well, Mr. Gordon never represented anybody on
01:37:01PM 23 transfer pricing issues, did he?

01:37:03PM 24 A. Not to my knowledge.

01:37:05PM 25 Q. Neither Mr. Quinn nor Mr. Gordon, whose expertise you

say would be so important in working on your audit, neither one of them have any experience at all in litigating audit questions, have they?

A. To the extent the audit questions deal with complex experts and items of commercial or IP law, which are overlapped here since we are talking about intangibles, or interpretation of contracts, representation of valuations, I think they do have some of that expertise in their either intellectual property or antitrust litigation. So that was the kind of expertise we were looking to supplement. We had very good transfer pricing -- that is, the transfer pricing, legal expertise in the IRS.

Q. My question is, did either of these gentlemen have any experience in litigating tax audit issues?

A. It depends on what your definition of what "tax audit issues" is. If you are asking did they have experience litigating transfer pricing issues, then my answer is no, I don't believe so.

Q. Now, the timeline here, the generic timeline, talks about when you are going to do things like issue IDRs. Those are information document requests, right?

A. Correct.

Q. And then -- Does it talk about interviews in here somewhere?

A. There is a number of discussions about interviews. I

01:38:46PM 1 think in the early stage they talk about talking to the
01:38:49PM 2 businesspeople. Later on they suggest, you know, thinking
01:38:52PM 3 about whether or not you need to do interviews as well.

01:38:55PM 4 But it is not in here, it is in the meat of the document.

01:38:58PM 5 Q. And then the final stages are resolution discussions,
01:39:02PM 6 and then final NOPA -- This is on the bottom right-hand
01:39:07PM 7 corner. What does that stand for?

01:39:08PM 8 A. Notice of proposed adjustment. So if we are not
01:39:12PM 9 issuing a statutory notice, we typically issue a notice of
01:39:15PM 10 proposed adjustment.

01:39:16PM 11 Q. Would that be like a 30-day letter?

01:39:19PM 12 A. I think it accompanies the 30-day letter, strictly
01:39:22PM 13 speaking.

01:39:23PM 14 Q. And then case closed, right?

01:39:25PM 15 A. No.

01:39:27PM 16 Q. Case closing? That's what it says, right?

01:39:32PM 17 A. "Case closing," that means, you know, at some point
01:39:34PM 18 if exam's finished up their stuff, then either it goes
01:39:38PM 19 from a 30-day letter to a stat notice, or from a 30-day
01:39:41PM 20 letter to appeals.

01:39:42PM 21 There is also a note at the last page about continuing
01:39:45PM 22 reevaluating the timeline. And one of the notes, that
01:39:48PM 23 could happen after this, is, it says, that if the taxpayer
01:39:51PM 24 presents new legal or factual issues, or anything survives
01:39:57PM 25 in the protest, consider pulling the NOPA and reopening

01:40:00PM 1 the case. I think that is in the last page of this
01:40:03PM 2 roadmap.

01:40:03PM 3 Q. Let's take a look at Exhibit 78. Was this a proposed
01:40:13PM 4 timeline concerning the Microsoft audit, dated around
01:40:23PM 5 July 12th, 2012?

01:40:27PM 6 A. Yes. Basically, when we were meeting with Microsoft
01:40:31PM 7 they asked us if there were milestones, and this was the
01:40:33PM 8 first effort to do so.

01:40:36PM 9 Q. And the timeline basically contemplated a total of
01:40:41PM 10 about an additional 16 months until closure, right?

01:40:44PM 11 A. Do you want me to do a map? This is from July
01:40:50PM 12 until --

01:40:50PM 13 Q. Well, we are starting July of 2012 --

01:40:53PM 14 A. It went from the statute extension date.

01:40:57PM 15 October 30th was when the statute was extended to. We
01:41:00PM 16 just worked backwards. We knew that we needed at least
01:41:04PM 17 three months, if we didn't reach resolution, to decide
01:41:06PM 18 whether to issue a 30-day letter or a stat notice. And
01:41:10PM 19 then we just went backwards and tried to fit everything
01:41:13PM 20 else, as best we could, into the remaining time.

01:41:15PM 21 Q. And so it is starting -- Actually, I overstated it.
01:41:19PM 22 Starting in July of 2012, and you are contemplating that
01:41:28PM 23 you can wrap this thing up in about twelve months,
01:41:34PM 24 resolution of issues or issuance of a 30-day letter,
01:41:37PM 25 right?

01:41:38PM 1 A. That's what it says. As I mentioned, we just worked
01:41:41PM 2 back from the statute expiration date. We knew we needed
01:41:46PM 3 three months if we had to issue a stat notice. The normal
01:41:48PM 4 course, though, is we don't aspire to issue a stat notice.
01:41:52PM 5 The normal course in every audit is we normally -- just --
01:41:54PM 6 if we have un-agreed issues, we usually do a 30-day
01:41:56PM 7 letter. A stat notice is a future decision that we make
01:42:00PM 8 after developing the facts and seeing what the taxpayer
01:42:02PM 9 does.

01:42:03PM 10 Q. You mentioned the statute of limitations date. Is it
01:42:06PM 11 the case, as of July 12th, 2012, Microsoft had agreed to
01:42:12PM 12 an extension of the statute of limitation that would take
01:42:15PM 13 it out to October 30, 2013?

01:42:18PM 14 A. I believe so.

01:42:20PM 15 Q. And your timeline said, "Well, we can get it done
01:42:25PM 16 within that time period," right?

01:42:26PM 17 A. That was our goal. There is some notes at the bottom
01:42:32PM 18 that you can't see, but it basically talks about things
01:42:35PM 19 that have to happen for this to actually be successful.

01:42:38PM 20 Q. Exhibit 79, is this an updated timeline prepared
01:42:46PM 21 July 31, 2013?

01:42:48PM 22 A. It is.

01:42:49PM 23 Q. And by this time the dates had slipped somewhat,
01:42:53PM 24 right?

01:42:53PM 25 A. Yeah. And there is discussions about why in there.

01:42:58PM 1 Q. And even with the dates slipping and the discussion
01:43:00PM 2 about why, as of July 31, 2013, your target for wrapping
01:43:08PM 3 this up was just nine months down the road, right?

01:43:11PM 4 A. Again, we worked back from the statute of
01:43:13PM 5 limitations, which at that point in time was
01:43:15PM 6 December 31st, 2013.

01:43:19PM 7 Q. Microsoft had, I take it, agreed to still another
01:43:23PM 8 extension of the statute of limitations, right?

01:43:25PM 9 A. Yeah, they had. They were interested in hearing, at
01:43:28PM 10 least I understood at that time, where we were. And we
01:43:32PM 11 had always talked to them throughout this process about
01:43:34PM 12 trying to resolve one or more issues.

01:43:37PM 13 Q. There was -- Let me just get back here. There was a
01:43:46PM 14 possibility that you identified that there might be a need
01:43:54PM 15 for some new IDRs, some information document requests,
01:43:58PM 16 right?

01:43:59PM 17 A. Certainly there is a couple of places referred to
01:44:02PM 18 here. The top one is focusing on things we need to do to
01:44:08PM 19 get to having intelligent conversation at this resolution
01:44:11PM 20 meeting, where we present our -- Note 1 actually reserves
01:44:14PM 21 on doing interviews and IDRs outside of anything that you
01:44:17PM 22 see in the boxes above.

01:44:19PM 23 Q. Yeah. Note 1, let's look at that. I have
01:44:25PM 24 highlighted some language. Of course, the audit has been
01:44:29PM 25 going on now for six, seven years, right?

01:44:31PM 1 A. Yeah. At this point we are just focusing on the
01:44:35PM 2 focus with the expertise that we didn't previously have on
01:44:39PM 3 the transfer pricing issues, specifically Americas.

01:44:41PM 4 Q. So tons of information has already been turned over.
01:44:46PM 5 What you say there in Note 1 is, "The majority of
01:44:50PM 6 data-intensive IDRs have been issued already, and based on
01:44:53PM 7 what is currently known, we believe that all reasonably
01:44:56PM 8 anticipated IDRs will be issued by June 30" -- and that
01:45:01PM 9 would be June 30, 2013 -- "and most significantly sooner,"
01:45:08PM 10 right?

01:45:09PM 11 A. That was our goal. I think until we identified new
01:45:14PM 12 issues, you know, that weren't resolved after the
01:45:17PM 13 January 14th meeting, we more or less meant that -- The
01:45:21PM 14 caveat was, and I think it is reflected in the next -- in
01:45:25PM 15 either that one or this one, is -- We still had a lot of
01:45:28PM 16 questions on software code. And that was one of the
01:45:30PM 17 reasons we needed more time, to do a software code
01:45:33PM 18 analysis, and to get some answers about -- like a
01:45:36PM 19 stack-full of reports that the company had given us that
01:45:38PM 20 we didn't have previously, their internal software code
01:45:44PM 21 analysis.

01:45:44PM 22 Q. Exhibit 134 is a May 2013 update of timeline, right?

01:45:50PM 23 A. It is.

01:45:52PM 24 Q. And you had these software issues, other issues. Now
01:46:01PM 25 you are in the present, which would be May 30, 2013, and

01:46:08PM 1 you are projecting that in less than a year you will be
01:46:14PM 2 able to resolve the issues or issue a 30-day letter,
01:46:18PM 3 right?

01:46:18PM 4 A. Yeah. So this was updated after we actually were
01:46:22PM 5 able to schedule our software code visits to the company.
01:46:25PM 6 That is in Note 2. This reflects that. And, frankly, we
01:46:29PM 7 were basically on this schedule until the government
01:46:32PM 8 shutdown. But we had a meeting scheduled with the
01:46:34PM 9 taxpayer, before the shutdown, for the first week in
01:46:37PM 10 December, which was the first availability for both the
01:46:39PM 11 taxpayer's executives and ours.

01:46:41PM 12 Q. And, once again, at the IRS's request, Microsoft had
01:46:47PM 13 extended the statute of limitations out to June 30, 2014,
01:46:53PM 14 right?

01:46:53PM 15 A. Yeah, they agreed to. We told them we wanted to meet
01:46:57PM 16 with them and discuss resolution and narrow issues, and
01:46:59PM 17 they agreed to extend.

01:47:00PM 18 Q. Also in here, what you were projecting is that within
01:47:24PM 19 just five months you would be able to present your
01:47:28PM 20 conclusions to the taxpayer, and then there would be a
01:47:34PM 21 period of four or five months of discussions, and by April
01:47:41PM 22 of 2014 you thought you would be able to wrap this up,
01:47:43PM 23 right?

01:47:43PM 24 A. We discussed this at length with Mr. Sample and
01:47:48PM 25 Mr. Bernard on multiple occasions. They said, "Do you

01:47:51PM 1 really think we are going to be able to resolve all issues
01:47:54PM 2 in two or three months between the presentation and our
01:47:57PM 3 D-Day for decision?" We told them, "Look, you know, we
01:48:00PM 4 need a place to start, working back from the statute."
01:48:02PM 5 How much we resolved and how much we talked was up to
01:48:05PM 6 them. We recognized to hit all of the issues would
01:48:07PM 7 probably take more time. The ball was in their court.
01:48:12PM 8 Q. And in the event the November 2013 date for the IRS
01:48:20PM 9 presenting their conclusions ended up slipping to, I think
01:48:24PM 10 you said, January 2014, right?
01:48:26PM 11 A. After the government shutdown it was mutually
01:48:30PM 12 rescheduled for January 14th, correct. Originally we
01:48:34PM 13 scheduled for December.
01:48:35PM 14 Q. I only have an hour. I only asked you whether it
01:48:37PM 15 slipped to January 2014.
01:48:39PM 16 A. We rescheduled to January 14th, yes.
01:48:41PM 17 Q. You had a face-to-face meeting with Microsoft, right?
01:48:44PM 18 A. As well as their attorneys, yes.
01:48:46PM 19 Q. And you were the lead presenter for the IRS?
01:48:49PM 20 A. I was.
01:48:50PM 21 Q. Right?
01:48:53PM 22 A. I was.
01:48:54PM 23 Q. You had a big thick slide deck with 60, 65 or so
01:49:00PM 24 slides, right?
01:49:00PM 25 A. Two reports about 200 pages and a bunch of Excel

01:49:04PM 1 spreadsheets.

01:49:04PM 2 Q. This was part of the IRS's effort to try to reach
01:49:09PM 3 resolution of the issues, correct?

01:49:10PM 4 A. It was to intelligently discuss the analysis to date,
01:49:16PM 5 to identify open questions we had, and to propose a path
01:49:19PM 6 towards resolution on those open questions.

01:49:21PM 7 Q. Can you say yes or no to whether this was part of the
01:49:23PM 8 IRS's effort to try to reach resolution of the issues?

01:49:26PM 9 A. It was.

01:49:27PM 10 Q. Thanks.

01:49:29PM 11 A. You're welcome.

01:49:30PM 12 Q. Now, in your earlier testimony you said that these
01:49:35PM 13 discussions irretrievably broke down in July of 2014. Do
01:49:42PM 14 you remember that?

01:49:42PM 15 A. I do. That's the first time we were unequivocally
01:49:46PM 16 told that they didn't want to talk to us at all, and said
01:49:50PM 17 finish our case.

01:49:51PM 18 Q. Actually, you had been told earlier than that that
01:49:54PM 19 Microsoft didn't want to pursue further resolution
01:50:00PM 20 discussions, and in fact wanted you to finally issue that
01:50:03PM 21 30-day letter so they could get on to tax court, right?

01:50:07PM 22 A. That mischaracterizes the conversations. As late as
01:50:11PM 23 May we were still talking to Microsoft about at least
01:50:14PM 24 engaging on some of the mechanical issues.

01:50:16PM 25 Q. On February 17th, 2014, did you and Mr. Maruca of the

01:50:22PM 1 IRS have a conference call with Mr. Sample and Mr. Bernard
01:50:27PM 2 of Microsoft?

01:50:28PM 3 A. That sounds right.

01:50:29PM 4 Q. And did Mr. Sample inform you that Microsoft would
01:50:34PM 5 not further pursue dispute resolution discussions?

01:50:37PM 6 A. What he said at that time is -- He did say that he
01:50:42PM 7 wasn't sure they could pursue it. We expressed concerns
01:50:46PM 8 and disappointment. We also left open the door for
01:50:49PM 9 resolution. They also continued to commit to us to
01:50:51PM 10 provide us feedback on some of the open mechanical
01:50:54PM 11 questions which they had committed to on January 14th. So
01:50:58PM 12 we left that meeting still with a commitment from
01:51:02PM 13 Microsoft to engage with us on some -- not all, but some
01:51:06PM 14 of the resolution items we had hoped to discuss.

01:51:09PM 15 Q. I am putting up your sworn declaration, Exhibit 77,
01:51:13PM 16 Paragraph 41. "On February 17, 2014, on a conference call
01:51:17PM 17 held among Mr. Sample, Mr. Bernard, Mr. Maruca, and me,
01:51:22PM 18 Mr. Sample notified us that he planned to sign a statute
01:51:26PM 19 of extension that week, extending the statute to
01:51:28PM 20 December 31, 2014; that he had decided not to pursue
01:51:35PM 21 resolution discussions; and that he would like a 30-day
01:51:43PM 22 letter." Now, in your sworn declaration, when you
01:51:51PM 23 summarized what Mr. Sample said, all you said was that he
01:51:55PM 24 decided not to pursue resolution discussions and he would
01:51:58PM 25 like a 30-day letter, correct?

01:52:01PM 1 A. If you look a few down, it says he still remained
01:52:06PM 2 committed on giving us a 60-day feedback, I believe. And
01:52:09PM 3 on a 60-day feedback, if you have the context of the
01:52:11PM 4 January 14th meeting, and this particular conversation,
01:52:15PM 5 that feedback was on these mechanical issues that we had
01:52:18PM 6 raised questions on, how to identify revenues for
01:52:20PM 7 geographies, how to identify expenses, and how to do
01:52:23PM 8 allocations, and these math errors and judgment calls that
01:52:28PM 9 we wanted to engage on. That was what the 60-day feedback
01:52:31PM 10 was supposed to focus on.

01:52:33PM 11 Q. Did you issue the 30-day letter like Microsoft asked
01:52:36PM 12 you to?

01:52:36PM 13 A. We did not.

01:52:37PM 14 Q. On March 24, 2014, did you have a meeting with
01:52:42PM 15 Mr. Bernard of Microsoft, I think in Washington, DC?

01:52:49PM 16 A. I did.

01:52:50PM 17 Q. Did he reiterate Microsoft's request for a 30-day
01:52:53PM 18 letter?

01:52:53PM 19 A. He did.

01:52:53PM 20 Q. Did you issue one?

01:52:54PM 21 A. No.

01:52:55PM 22 Q. Ms. Eakes in her opening referred to Exhibit 126.
01:53:06PM 23 And we just talked about March 24, 2014, where they
01:53:12PM 24 reiterated the request for a 30-day letter. Ms. Eakes
01:53:18PM 25 referred to Exhibit 126, which was a March 28th, 2014

01:53:27PM 1 email, just a few days afterwards, where the folks at the
01:53:36PM 2 IRS are saying we really need to get this temporary
01:53:41PM 3 regulation out by June 1st, 2014.

01:53:47PM 4 Now, my question is simply, did you personally know
01:53:53PM 5 within days of being told by Mr. Bernard that further
01:54:00PM 6 discussions weren't going to work, and that Microsoft
01:54:02PM 7 wanted a 30-day letter, did you know yourself that the IRS
01:54:08PM 8 was putting the hurry-up on this temporary regulation?

01:54:12PM 9 A. I was not aware of this email or any of these
01:54:16PM 10 comments here.

01:54:17PM 11 Q. Had you told others in your group, in this timeframe,
01:54:23PM 12 that Microsoft had said further discussions aren't going
01:54:26PM 13 to work and we want the 30-day letter?

01:54:31PM 14 A. I am sure I made an internal report at some point.

01:54:34PM 15 Q. Was there anybody in your group who had that
01:54:39PM 16 information, who was dealing with the people who were
01:54:42PM 17 deciding to hurry up the temporary regulation?

01:54:45PM 18 A. Not to my knowledge.

01:54:45PM 19 Q. Who in your group would have interfaced with the guys
01:54:50PM 20 working on the temporary regulation?

01:54:54PM 21 A. I don't know about anyone in my group interfacing
01:54:57PM 22 directly with them until later -- that early June
01:55:02PM 23 timeframe. So persons in my group who I knew at some
01:55:06PM 24 point -- I don't know when they started to interact with
01:55:10PM 25 the reg, as I mentioned before, were Tom Berger -- I'm

01:55:13PM 1 sorry, Howard Berger, Tom Ralph, and Sam Maruca.

01:55:21PM 2 Q. I am putting up a timeline that your counsel had
01:55:24PM 3 prepared for use in the case. According to your timeline
01:55:30PM 4 here, I will just put a little arrow next to the points I
01:55:39PM 5 am talking about, in November/December 2013 is when the
01:55:51PM 6 IRS contacted Quinn Emanuel, right?

01:55:53PM 7 A. Correct.

01:55:54PM 8 Q. Did you do the contacting?

01:55:57PM 9 A. Not initially, but during that timeframe and
01:56:01PM 10 follow-up conversations, yes.

01:56:02PM 11 Q. Are there records, memos, phone records, that if we
01:56:08PM 12 got discovery we might be able to look at that would tell
01:56:12PM 13 us what it was you discussed with Quinn Emanuel?

01:56:15PM 14 A. No. I think at that point in time there would have
01:56:19PM 15 been phone calls and possibly an NDA.

01:56:23PM 16 Q. What's an NDA?

01:56:25PM 17 A. A nondisclosure agreement.

01:56:27PM 18 Q. And you don't think there is any emails or memos that
01:56:33PM 19 say, "Gee whiz, Eli talked to Quinn Emanuel, and here is
01:56:39PM 20 where we look like we are going"?

01:56:42PM 21 A. Honestly, at that stage we are just reaching out to
01:56:46PM 22 ascertain whether there is interest in them working for
01:56:49PM 23 the IRS. As things progress we start to talk about the
01:56:55PM 24 contours of expert engagements. I honestly don't know
01:57:00PM 25 where in time you would start to see some documents

01:57:06PM 1 discussing --

01:57:07PM 2 Q. Somewhere in time you would start to see some
01:57:09PM 3 documents discussing that, which we could look at if we
01:57:13PM 4 got discovery, right?

01:57:14PM 5 A. I would imagine so, if they weren't privileged.

01:57:17PM 6 Q. February 25th, you actually met with Quinn Emanuel.
01:57:22PM 7 Where was that meeting?

01:57:23PM 8 A. It was in Los Angeles.

01:57:24PM 9 Q. Did you fly out there and attend it?

01:57:27PM 10 A. I did.

01:57:28PM 11 Q. How many people from the IRS were there?

01:57:30PM 12 A. Three.

01:57:31PM 13 Q. How many people from Quinn Emanuel were there?

01:57:33PM 14 A. Three or four, that I can recall.

01:57:37PM 15 Q. Did you generate any documents, you or your
01:57:41PM 16 colleagues, describing what was talked about in this
01:57:43PM 17 meeting with Quinn Emanuel?

01:57:44PM 18 A. Not describing what was talked about. I may have
01:57:50PM 19 used some visual aids there.

01:57:53PM 20 Q. And if we got discovery, we could look at your visual
01:57:57PM 21 aids, assuming that you don't claim some sort of
01:57:59PM 22 privilege, right?

01:58:00PM 23 A. Of course.

01:58:00PM 24 Q. Did you say that they didn't even know that Microsoft
01:58:11PM 25 was the company that they would be helping you go against?

01:58:17PM 1 A. I did not say that.

01:58:18PM 2 Q. Okay. They did know it was Microsoft --

01:58:22PM 3 A. Once we have executed a nondisclosure agreement.

01:58:26PM 4 That is the first step. And after we get signed

01:58:28PM 5 nondisclosure agreements, just with respect to the people

01:58:31PM 6 that have executed them, we will inform them of the

01:58:33PM 7 potential taxpayer to eliminate things like conflicts.

01:58:38PM 8 Q. So when did you get these nondisclosure agreements?

01:58:43PM 9 A. I don't know exactly. The first one was probably in

01:58:46PM 10 that November/December timeframe.

01:58:47PM 11 Q. So way back in November/December they knew right from

01:58:51PM 12 the get-go that they were being asked whether they would

01:58:54PM 13 be interested in helping you go against Microsoft, right?

01:58:58PM 14 A. At some early point, yes.

01:59:00PM 15 Q. So then the engagement letter is signed on May 19th,

01:59:06PM 16 2014, right?

01:59:07PM 17 A. That sounds right. It was not an engagement letter,

01:59:13PM 18 we had a contract.

01:59:15PM 19 Q. We will come back to that. That is another subject

01:59:17PM 20 you are all geared up on for today's testimony, right?

01:59:24PM 21 A. If you would like to ask me about it, I would be

01:59:28PM 22 happy to answer questions.

01:59:29PM 23 Q. Oh, I will. Now, by May 19, 2014, the statute of

01:59:33PM 24 limitations had been extended several times, correct?

01:59:35PM 25 A. Yes. Each time agreed to by Microsoft.

01:59:38PM 1 Q. Right. You asked and Microsoft agreed, right?

01:59:40PM 2 A. Yes.

01:59:40PM 3 Q. And as of late 2013 -- It was set to expire in June
01:59:47PM 4 of 2014, right?

01:59:48PM 5 A. That sounds right.

01:59:50PM 6 Q. And around December of '13, did you ask Microsoft for
01:59:57PM 7 still another extension?

01:59:59PM 8 A. I don't know exactly when that request was made, but
02:00:03PM 9 sometime in December, January, February, yes.

02:00:06PM 10 Q. Sometime in December, January, February. Did you
02:00:09PM 11 tell them when you asked for this new extension that you
02:00:13PM 12 had contacted Quinn Emanuel and were in discussions with
02:00:21PM 13 Quinn Emanuel about them helping you out and going against
02:00:24PM 14 Microsoft?

02:00:25PM 15 A. We did not at that point in time inform them of our
02:00:28PM 16 discussions with Quinn Emanuel.

02:00:30PM 17 Q. And did you tell them that part of Quinn Emanuel's
02:00:35PM 18 role was -- it was contemplated that they would actually
02:00:41PM 19 appear in tax court against Microsoft? Did you tell them
02:00:45PM 20 that?

02:00:45PM 21 A. I did not tell them anything at all with respect to
02:00:49PM 22 Quinn Emanuel at that time.

02:00:51PM 23 Q. You kept all of that secret, right?

02:00:53PM 24 A. Well, I am not in the habit of discussing potential
02:00:57PM 25 experts with any taxpayer, Microsoft or otherwise, prior

to them having a reason to interact with the taxpayer.

Q. This is a little different, because you are asking somebody to voluntarily extend the statute of limitations, and you are concealing from them the fact that for the first time ever, in your knowledge, the IRS was hiring an outside law firm to help it with the audit, and looking forward to representing them in tax court. You didn't tell them that, did you?

A. In the last part, if you are asking did I tell them, no, I didn't tell them. The rest of it, I don't think it accurately characterizes why we asked for extensions at the six-month mark. We are directed to do that at six months under the IRM, the Internal Revenue Manual, it is my understanding. Other people actually handle that, people who manage the statutes. But at the six-month mark our instructions say, no later than that, see if you can get an extension. And if we don't, then we have to decide what we are going to do to prepare for the statute to expire.

Q. The meeting in February, where you had like three folks from the IRS, three folks from Quinn Emanuel, did you discuss with Quinn Emanuel your need to get another extension of the statute of limitations if Quinn Emanuel was to be able to come onboard?

MR. WEAVER: I will object, your Honor, and assert

02:02:17PM 1 the attorney-client privilege. Quinn Emanuel ended up
02:02:21PM 2 advising the IRS on legal matters. Although I don't
02:02:25PM 3 really care about this question, I don't want to open the
02:02:28PM 4 door to some subject matter.

02:02:29PM 5 THE COURT: The objection will be sustained.
02:02:32PM 6 By Mr. Beck:

02:02:38PM 7 Q. Was it in February of 2014, the same month that you
02:02:42PM 8 met with Quinn Emanuel, that you finally persuaded
02:02:47PM 9 Microsoft to give you still another extension of the
02:02:51PM 10 statute of limitations?

02:02:53PM 11 A. I am not sure of when they extended it.

02:02:57PM 12 Q. Exhibit 148. You can see here, I think, that this
02:03:07PM 13 extension to the end of the year was granted on
02:03:17PM 14 February 28th, 2014. Do you see that?

02:03:19PM 15 A. I do.

02:03:20PM 16 Q. So that was just a few days after your meeting with
02:03:25PM 17 Quinn Emanuel, correct?

02:03:26PM 18 A. Yes.

02:03:27PM 19 Q. Then back to our timeline -- your timeline, rather.
02:03:40PM 20 May 19, 2014, that's where your entry says you executed a
02:03:50PM 21 contract with Quinn Emanuel, right?

02:03:51PM 22 A. That's when the contracting officer awarded the
02:03:55PM 23 contract.

02:03:57PM 24 Q. Let's take a look now at Exhibit 71. This is a
02:04:11PM 25 letter from you to Mr. Bernard, dated August 28th, 2014.

02:04:20PM 1 Do you see that?

02:04:21PM 2 A. I do.

02:04:22PM 3 Q. And you were talking about logistics for upcoming
02:04:25PM 4 interviews that Microsoft had agreed that they would
02:04:30PM 5 provide their people for, right?

02:04:31PM 6 A. This was our initial request for those interviews
02:04:34PM 7 from the pool of people that Microsoft identified.

02:04:36PM 8 Q. Well, you had already been in conversations with
02:04:41PM 9 them, and they had already agreed to make the people
02:04:44PM 10 available before you sent this letter, right?

02:04:46PM 11 A. Not necessarily. We had asked them to identify
02:04:50PM 12 persons who could speak to various subject matters for
02:04:55PM 13 purposes of scheduling these interviews. And once they
02:04:58PM 14 identified that pool, we made that request that these are
02:05:02PM 15 the people and the times we would like to speak to them.

02:05:03PM 16 Q. Look at your letter. Your letter says, "Thank you
02:05:06PM 17 for agreeing to make available for interview the below
02:05:09PM 18 listed employees." They had already agreed, right?

02:05:12PM 19 A. They had suggested them as possible persons. So,
02:05:16PM 20 yeah, it is basically feel-good language saying, "Hey,
02:05:19PM 21 thanks for talking to us, thanks for giving us candidates,
02:05:21PM 22 here are the people we are talking to."

02:05:24PM 23 Q. Actually, you said, "Thank you for agreeing to make
02:05:28PM 24 them available," right?

02:05:29PM 25 A. I did. That's what I wrote.

02:05:29PM 1 Q. When you asked them to make these folks available,
02:05:32PM 2 did you tell them that, incidentally, we have hired
02:05:36PM 3 outside counsel for the first time in the history of the
02:05:39PM 4 universe and Quinn Emanuel is going to be asking some of
02:05:42PM 5 the questions?

02:05:43PM 6 A. This is the first letter where I informed them --

02:05:47PM 7 Q. This is the first time, am I right, that you made any
02:05:51PM 8 reference to Microsoft, after they had already agreed to
02:05:55PM 9 these interviews, that Quinn Emanuel would be involved,
02:06:00PM 10 correct?

02:06:00PM 11 A. Yes, this is the first time I told them about Quinn
02:06:05PM 12 Emanuel.

02:06:05PM 13 Q. And it was almost like an aside, Page 3, "Oh, by the
02:06:12PM 14 way, in addition to our economist and industry experts,
02:06:14PM 15 this may include outside counsel from Quinn Emanuel
02:06:16PM 16 retained to assist LB&I in its evaluation and examination
02:06:21PM 17 in this matter"? That was the entire disclosure, right?

02:06:25PM 18 A. That's what it says.

02:06:26PM 19 Q. And, of course, you really couldn't delay telling
02:06:30PM 20 them anymore because the statute of limitations was about
02:06:33PM 21 to expire, right?

02:06:34PM 22 A. Listen, we didn't have Quinn Emanuel hired and on
02:06:39PM 23 board and cleared to do work until the middle of July. We
02:06:42PM 24 had started discussions with them, with Microsoft, prior
02:06:45PM 25 to that. As early as May we actually asked them to

02:06:48PM 1 identify people. This was the first time where we
02:06:51PM 2 actually started to receive the names from Microsoft. And
02:06:54PM 3 we could say, yeah, we would like to talk to some of the
02:06:57PM 4 people you have identified.

02:06:58PM 5 Q. Was the statute --

02:06:59PM 6 A. This was an appropriate time in my mind --

02:07:00PM 7 Q. Was the statute about to expire? My question was,
02:07:03PM 8 was the statute of limitations about to expire?

02:07:06PM 9 A. The statute of limitations was set to expire December
02:07:09PM 10 31st, 2014.

02:07:11PM 11 Q. And were you concerned that if you showed up with
02:07:13PM 12 Quinn Emanuel completely unannounced before these
02:07:16PM 13 interviews took place, the interviews wouldn't go forward,
02:07:20PM 14 right?

02:07:20PM 15 A. I told them about a month before we asked for them so
02:07:25PM 16 they had an opportunity to consider them. Certainly I
02:07:27PM 17 wanted them to know. And if they had some issues, which
02:07:30PM 18 they did, they were free to raise them, which they did.

02:07:32PM 19 Q. Let's take a look at how they raised the issues and
02:07:35PM 20 how you responded. Exhibit 72, this is Mr. Bernard's
02:07:49PM 21 response to you?

02:07:49PM 22 A. It is.

02:07:50PM 23 Q. He says we are going to go forward with the
02:07:56PM 24 interviews on a consensual basis, right?

02:08:03PM 25 A. I suppose so, yes.

02:08:08PM 1 Q. Then over on Page 2 he has a discussion of concerns
02:08:13PM 2 about Quinn Emanuel, correct?

02:08:15PM 3 A. He does.

02:08:18PM 4 Q. And, again, with time being what it is, I will try to
02:08:22PM 5 summarize. The one thing he asked you was, are you
02:08:29PM 6 claiming these guys are going to be expert witnesses, or
02:08:36PM 7 are they going to be representing IRS as trial counsel if
02:08:40PM 8 this proceeds to go to litigation, right?

02:08:44PM 9 A. That is the sentence.

02:08:46PM 10 Q. And then he says, "We are concerned about their
02:08:49PM 11 involvement. They have been adverse to us in many
02:08:54PM 12 matters. They represent our biggest competitors." Did
02:08:57PM 13 you take any of that into account when you decided that
02:09:00PM 14 Quinn Emanuel is the right firm to go against Microsoft?

02:09:03PM 15 A. You mean that they have been --

02:09:07PM 16 Q. That they had 30 open matters adverse to Microsoft,
02:09:12PM 17 did you take that into account?

02:09:13PM 18 A. I took into account whether they had the expertise
02:09:15PM 19 needed, and whether or not there was a conflict that would
02:09:18PM 20 bar them from representing the IRS or bar them from being
02:09:21PM 21 adverse to Microsoft.

02:09:23PM 22 Q. Did you take into account they had 30 open matters
02:09:26PM 23 against Microsoft when you decided they are the right
02:09:29PM 24 people to go against Microsoft on their behalf?

02:09:33PM 25 MR. WEAVER: Objection. Foundation.

02:09:34PM 1 THE COURT: The objection will be sustained.

02:09:35PM 2 By Mr. Beck:

02:09:35PM 3 Q. Did you make any inquiry as to how many open active
02:09:38PM 4 matters they had against Microsoft?

02:09:42PM 5 A. I did not ask them the number of matters of which
02:09:45PM 6 they were adverse to Microsoft.

02:09:47PM 7 Q. Did you later learn that it was 30 or more? Yes or
02:09:52PM 8 no, did you later learn that it was 30 or more?

02:09:54PM 9 A. There is a list on the document that was provided to
02:09:57PM 10 Microsoft. I don't know if those were current matters or
02:10:00PM 11 historical ones. I don't know how many at any point in
02:10:02PM 12 time they were adverse.

02:10:03PM 13 Q. You didn't care, right?

02:10:05PM 14 A. I didn't see it as an issue. Their being adverse to
02:10:08PM 15 Microsoft in our case has no bearing, in my mind, whether
02:10:11PM 16 they are adverse in another, particularly when those
02:10:14PM 17 attorneys are not working on those other cases that are
02:10:16PM 18 active.

02:10:16PM 19 Q. Did you ask whether some of the biggest clients of
02:10:22PM 20 Quinn Emanuel also happened to be the biggest competitors
02:10:24PM 21 of Microsoft?

02:10:26PM 22 A. I had no reason to.

02:10:27PM 23 Q. It was of no interest to you that the people that you
02:10:32PM 24 were going to be turning all of our confidential
02:10:34PM 25 information over to were like principal outside counsel

02:10:39PM 1 for our biggest competitors, Google, Motorola?

02:10:43PM 2 MR. WEAVER: Objection. Foundation.

3 By Mr. Beck:

02:10:48PM 4 Q. Well, you later learned from us --

02:10:48PM 5 THE COURT: Just a second.

02:10:52PM 6 By Mr. Beck:

7 Q. You later learned from us, did you not --

02:10:53PM 8 I am withdrawing it and asking a different question.

9 THE COURT: Thank you.

10 By Mr. Beck:

02:10:55PM 11 Q. You later learned when we were complaining that one

02:10:57PM 12 of the reasons we didn't like this was because Quinn

02:11:01PM 13 Emanuel is outside counsel for Google and Motorola, two of

02:11:05PM 14 our biggest competitors, right?

02:11:08PM 15 A. I don't recall the actual names of the competitors

02:11:11PM 16 that were listed. I do recall Microsoft raising concerns

02:11:15PM 17 that Quinn Emanuel -- other attorneys, not necessarily the

02:11:18PM 18 ones that we hired, but other attorneys at Quinn Emanuel

02:11:20PM 19 were adverse to them.

02:11:21PM 20 Q. Did you make any inquiry into whether Quinn Emanuel

02:11:25PM 21 had a rather unfortunate recent history in being

02:11:29PM 22 sanctioned for not maintaining the confidentiality of

02:11:33PM 23 documents that had been entrusted in their care?

02:11:36PM 24 MR. WEAVER: Objection. Foundation.

02:11:37PM 25 THE COURT: The objection is sustained.

02:11:39PM 1 By Mr. Beck:

02:11:40PM 2 Q. Did you make inquiry?

02:11:41PM 3 MR. WEAVER: The same objection.

02:11:43PM 4 THE COURT: Sustained.

02:11:43PM 5 By Mr. Beck:

02:11:43PM 6 Q. Did you make any inquiry at all as to whether Quinn
02:11:49PM 7 Emanuel had been sanctioned in recent years concerning
02:11:52PM 8 their handling of confidential information?

02:12:00PM 9 A. No, not as part of the market survey. We did a
02:12:03PM 10 background check, we asked questions about the substance,
02:12:06PM 11 we talked to people we wanted to hire. That was the kind
02:12:10PM 12 of things we focused on, did they have the expertise, did
02:12:13PM 13 they seem like they were professional, did they understand
02:12:15PM 14 the obligations they would have to protect information if
02:12:18PM 15 you're hired as IRS contractors. That was the focus of
02:12:20PM 16 our inquiry at that stage.

02:12:22PM 17 Q. Did you know from news reports about their troubles
02:12:24PM 18 in that regard?

02:12:25PM 19 A. No.

02:12:25PM 20 Q. Let's look at Exhibit 73, your response to
02:12:33PM 21 Mr. Bernard. Over on Page 3, I want to focus on a couple
02:12:50PM 22 of the comments. This second paragraph you say, "Quinn
02:13:00PM 23 Emanuel has been hired to assist LB&I in its ongoing
02:13:04PM 24 evaluation and examination." That means the audit, right?

02:13:08PM 25 A. It does.

02:13:09PM 1 Q. "As communicated in prior discussions, the IRS has
02:13:12PM 2 not yet made a determination on how to process the agreed
02:13:16PM 3 issues in the fiscal 04/06 cycle, all options remain open,
02:13:24PM 4 and you can anticipate a final decision after the
02:13:26PM 5 interviews scheduled for September and October." Did that
02:13:30PM 6 mean at long last we were going to get either an all-clear
02:13:33PM 7 or a 30-day letter once these interviews took place?

02:13:37PM 8 A. No. As we discussed with Mr. Sample, and
02:13:41PM 9 Mr. Bernard, and as is referred to in Mr. Bernard's
02:13:44PM 10 outline for the March meeting, the options in play at that
02:13:47PM 11 point in time that we discussed with them were a 30-day
02:13:52PM 12 letter, it was a statutory notice of deficiency, or a
02:13:55PM 13 statutory notice of deficiency combined with a designation
02:13:57PM 14 for litigation.

02:13:59PM 15 Q. Wrap it up one way or another after the meetings in
02:14:04PM 16 September and October, right?

02:14:05PM 17 A. The same options that are available in every
02:14:07PM 18 examination, yes.

02:14:08PM 19 Q. And that's what they could anticipate, you told them,
02:14:11PM 20 in this letter, correct?

02:14:12PM 21 A. Yeah. We thought that the September and October
02:14:16PM 22 interviews would finish our factual development at that
02:14:19PM 23 point in time based on what we knew then.

02:14:21PM 24 Q. And you said that -- you assured them that Quinn
02:14:24PM 25 Emanuel had not been retained for litigation support,

02:14:26PM 1 right?

02:14:26PM 2 A. Well, the contract that was awarded was limited to
02:14:30PM 3 examination support.

02:14:32PM 4 Q. Well, you didn't say in the specific contract that
02:14:35PM 5 has been awarded it is limited to audit support, you said
02:14:41PM 6 Quinn Emanuel has not been retained for litigation
02:14:43PM 7 support, right?

02:14:43PM 8 A. Well, if you remember the last letter that you showed
02:14:46PM 9 me, it only gave two options. It was -- I don't remember
02:14:49PM 10 the first one, but it was basically expert witnesses or it
02:14:52PM 11 was trial litigation counsel. Well, they were retained to
02:14:56PM 12 provide support, consultation, legal advice, and support
02:14:58PM 13 during the examination. That was the contract that was
02:15:00PM 14 awarded. As we discussed previously today, we certainly
02:15:04PM 15 knew there was a possibility that if -- that things might
02:15:08PM 16 go to litigation, that they could, and if the IRS chose,
02:15:10PM 17 we could hire them in a new contract, but not this one,
02:15:14PM 18 because it didn't cover it.

02:15:15PM 19 Q. Well, you didn't tell them that in this letter. In
02:15:18PM 20 fact, you told them there was no contract?

02:15:20PM 21 A. I didn't say there was no contract.

02:15:22PM 22 Q. The next page. "The IRS does not have an engagement
02:15:27PM 23 letter with Quinn Emanuel." That's what you told them,
02:15:30PM 24 right?

02:15:30PM 25 A. I said no engagement letter. I did refer to the

02:15:33PM 1 scope of work.

02:15:34PM 2 Q. Yeah. But an engagement letter, of course you know
02:15:39PM 3 what that is, when you hire a lawyer it is a contract
02:15:42PM 4 between the client and the lawyer for the provision of
02:15:46PM 5 legal services, right?

02:15:48PM 6 A. Yeah, it is typically a letter on firm letterhead.
02:15:52PM 7 We don't have that in this case. We have a contract.
02:15:54PM 8 Now, in hindsight would it have been better to provide a
02:15:57PM 9 contract or make it a little more clear? Yes. But
02:16:00PM 10 Microsoft is a sophisticated taxpayer. And I discussed
02:16:03PM 11 the contracting process. And I know from past
02:16:04PM 12 conversations with them that they know that we award
02:16:06PM 13 contracts, not engagement letters. I wasn't ready at this
02:16:09PM 14 point in time to share a document that I was still
02:16:12PM 15 considering whether or not we could share it with them.
02:16:14PM 16 And this bought me some time.

02:16:16PM 17 Q. You tricked them?

02:16:17PM 18 A. I don't think I tricked them. I described the scope
02:16:19PM 19 of work.

02:16:19PM 20 Q. Let's back up. They said, "Give us a copy of the
02:16:22PM 21 engagement letter." And you said, "I don't have an
02:16:25PM 22 engagement letter." And your explanation is, "They are
02:16:29PM 23 sophisticated. If they ask for an engagement letter, it
02:16:33PM 24 is fair for me to conceal the fact that I have a contract
02:16:36PM 25 because they didn't use the word 'contract'?"

02:16:38PM 1 A. The contract was public record. It was published on
02:16:41PM 2 the website. Mr. Bernard has previously looked at the
02:16:45PM 3 website for other contracts and seen when we --

02:16:47PM 4 Q. Answer my question, will you?

02:16:48PM 5 A. He asked for an engagement letter; we don't have one.

02:16:51PM 6 Q. And you didn't tell him you had a contract, did you?

02:16:53PM 7 A. I told him we had a scope of work.

02:16:58PM 8 Q. Who else was in on the decision to conceal the fact
02:17:02PM 9 that you had a contract?

02:17:04PM 10 MR. WEAVER: Objection. Mischaracterizes the
02:17:06PM 11 testimony.

02:17:06PM 12 THE COURT: The objection will be sustained.

02:17:08PM 13 By Mr. Beck:

02:17:08PM 14 Q. Who else did you talk to in the IRS about how when
02:17:12PM 15 responding to the request for the engagement letter, we
02:17:15PM 16 are going to say there is no engagement letter, and we are
02:17:18PM 17 not going to tell them that we have a contract?

02:17:21PM 18 A. I never discussed with anyone at the IRS not telling
02:17:24PM 19 them we had a contract. I did discuss with other persons
02:17:28PM 20 whether or not we had -- how we should respond here. To
02:17:31PM 21 the extent I had those discussions, it would have been
02:17:33PM 22 with IRS counsel.

02:17:35PM 23 Q. So this letter of yours followed discussions where
02:17:40PM 24 you got legal advice from counsel. Can you tell us which
02:17:44PM 25 lawyers? Was it Quinn Emanuel?

02:17:47PM 1 A. I discussed the issues with Bob Ratchford, IRS
02:17:51PM 2 counsel.

02:17:52PM 3 Q. How about anybody from Quinn Emanuel?

02:17:54PM 4 A. I made Quinn Emanuel aware that we had notified
02:18:00PM 5 Microsoft in this letter as to their being hired to assist
02:18:06PM 6 us in the examination.

02:18:09PM 7 Q. So then Mr. Bernard responds. And what he tells
02:18:21PM 8 you -- what you understood from this paragraph was that
02:18:26PM 9 even though you told them there was no engagement letter,
02:18:29PM 10 he had gone to a website where all government agencies are
02:18:34PM 11 required to post the existence of contracts. And he
02:18:39PM 12 discovered, notwithstanding what you told them, that in
02:18:42PM 13 fact there was a contract. He actually had the little
02:18:48PM 14 contract number. So he wrote back to you and said,
02:18:54PM 15 "Whether you want to call it an engagement letter, a
02:18:57PM 16 contract, an undertaking, give us the document," right?

02:19:01PM 17 A. He said what he said.

02:19:03PM 18 Q. So we reiterated, Microsoft did, the request for the
02:19:13PM 19 unredacted copy of the contract, right?

02:19:17PM 20 A. Yeah. This was the first time they specifically
02:19:22PM 21 asked for a contract, yes.

02:19:23PM 22 Q. But even you admit that here he used the language
02:19:31PM 23 where -- he said, "I want the contract." You had a
02:19:34PM 24 contract. And he asked for an unredacted one, right?

02:19:37PM 25 A. Yeah, that is what he asked for.

02:19:38PM 1 Q. You didn't give him one, though, did you?

02:19:40PM 2 A. I gave him an unredacted copy of the scope of work,
02:19:44PM 3 which describes all of the substantive work that Quinn
02:19:46PM 4 Emanuel was hired to perform.

02:19:47PM 5 Q. He asked for the unredacted copy of the contract, and
02:19:50PM 6 you didn't give him an unredacted copy of the contract,
02:19:53PM 7 did you?

02:19:53PM 8 A. I gave him what I was personally comfortable giving
02:19:56PM 9 him.

02:19:59PM 10 Q. Is there some reason that you wanted to conceal the
02:20:02PM 11 rest of the contract?

02:20:03PM 12 A. The reason I gave him the Schedule C was because
02:20:10PM 13 that's what describes the complete scope of work, what we
02:20:13PM 14 had asked them -- or hired them to perform. The reason I
02:20:14PM 15 didn't give him the rest is that I am not in the habit of
02:20:18PM 16 turning over IRS documents, particularly ones I am not the
02:20:21PM 17 custodian for, in total. And it is not under my expertise
02:20:25PM 18 what is or is not redacted.

02:20:28PM 19 So normally, my understanding is, when you want -- if
02:20:34PM 20 a taxpayer wants documents, unless someone decides on
02:20:37PM 21 their own to give out some portion of it, and we can
02:20:40PM 22 always make that choice, they go through our disclosures
02:20:43PM 23 office. They are the ones who know what gets redacted and
02:20:46PM 24 what doesn't. That is outside of my knowledge. And I was
02:20:49PM 25 comfortable giving him Schedule C, because that is the

02:20:53PM 1 meat of it, that is what we asked them to do. I thought
02:20:55PM 2 that would show them the four corners of what they had
02:20:57PM 3 been hired to do under this contract.

02:20:59PM 4 Q. Did you consult with counsel again on how you were
02:21:04PM 5 going to respond before you wrote this letter?

02:21:07PM 6 A. I made the decision on what to release myself. To
02:21:13PM 7 the extent there was ongoing discussions that required
02:21:18PM 8 legal advice, yes, I would have consulted with counsel.

02:21:22PM 9 Q. And here you not only said Section C contains the
02:21:25PM 10 full and unredacted performance, work statement, scope of
02:21:31PM 11 work, you said that was for all phases of the contract,
02:21:35PM 12 and the contract has one phase only. That's what you
02:21:39PM 13 represented to them, didn't you?

02:21:40PM 14 A. Yeah. And that's the truth.

02:21:42PM 15 Q. Let's take a look at that. In any event, before we
02:21:50PM 16 take a look at the actual contract to see whether that is
02:21:52PM 17 the truth, based on these representations that you made,
02:21:57PM 18 Microsoft agreed to go forward with those interviews,
02:22:01PM 19 right?

02:22:02PM 20 A. So the first week we didn't have Quinn Emanuel
02:22:06PM 21 present, but the interviews went forward. The second and
02:22:09PM 22 third weeks there were ongoing discussions about
02:22:14PM 23 procedures. And I don't think they were resolved at this
02:22:17PM 24 point in time. I don't think they were resolved until
02:22:20PM 25 maybe the 18th.

02:22:25PM 1 THE COURT: You have ten minutes, Mr. Beck.

02:22:27PM 2 MR. BECK: Thank you, your Honor.

02:22:29PM 3 By Mr. Beck:

02:22:32PM 4 Q. After the interviews -- you made this representation
02:22:39PM 5 to us, did you later learn that we had filed a FOIA
02:22:44PM 6 request on September 24, 2014, asking for a full
02:22:51PM 7 unredacted copy of the contract?

02:22:53PM 8 A. I did.

02:22:54PM 9 Q. Did you have anything to do with whether that FOIA
02:23:01PM 10 request should be responded to?

02:23:03PM 11 A. No.

02:23:03PM 12 Q. We eventually got a full unredacted copy of the
02:23:08PM 13 contract. Did you learn that?

02:23:10PM 14 A. I know you got a copy. I think there might be some
02:23:13PM 15 things that were redacted. I honestly don't know.

02:23:16PM 16 Q. Exhibit 64, that's a copy of the contract, right?

02:23:22PM 17 A. It looks like the first page.

02:23:25PM 18 Q. Did you negotiate this contract with Quinn Emanuel?

02:23:28PM 19 A. I don't negotiate contracts. That is a function that
02:23:31PM 20 the procurement officer does.

02:23:34PM 21 Q. What was your role in terms of the terms of this
02:23:38PM 22 contract?

02:23:39PM 23 A. I provided some input on the Schedule C that you saw;
02:23:43PM 24 and I also would have provided comments on F-6, which is
02:23:47PM 25 the delivery schedule; and I also would have provided some

02:23:53PM 1 comments because of the unique character of this with
02:23:55PM 2 respect to -- I think it is H-20. It is basically where
02:24:00PM 3 we talk about these extra hurdles we have to go through
02:24:03PM 4 because Quinn Emanuel, they were attorneys, they are a law
02:24:07PM 5 firm, and they had to comply with conflicts rules under
02:24:10PM 6 the relevant ethics rules.

02:24:13PM 7 Q. Let's take a look first over on Page 4. You gave us
02:24:21PM 8 Schedule C; is that right -- or Section C?

02:24:23PM 9 A. Yeah. So it is Section C. I guess I have been
02:24:27PM 10 talking "schedule." Originally in my letter I attached
02:24:31PM 11 Section C, yes.

02:24:31PM 12 Q. That is the only thing you gave us, right, Section C?

02:24:34PM 13 A. That was the only thing I was personally responsible
02:24:37PM 14 for providing Microsoft, yes.

02:24:38PM 15 Q. That is the only thing you gave us, right?

02:24:40PM 16 A. Well, there is descriptions of what they did or
02:24:42PM 17 didn't do, and what their conflicts were, in the letter,
02:24:45PM 18 so it is not the only thing I gave you.

02:24:46PM 19 Q. So now Section B, something that you didn't give us,
02:24:51PM 20 section B says, "Performance outside of the scope and/or
02:24:55PM 21 above the firm fixed price." And then it says, "For each
02:25:01PM 22 phase." Do you see that?"

02:25:02PM 23 A. I do. If you look at the schedules there is only one
02:25:04PM 24 phase.

02:25:05PM 25 Q. You told us there was only one phase, but the

contract talks about each phase, right?

A. Yeah. So this is pro forma language. Oftentimes you will see references to each phase or look at the phases. But then you have to look at the schedule, which I think is either the page before or page after this, and then Schedule C -- or Section C to see what the phases are. If there is only one phase, then this only applies to one phase.

Q. And there is a fixed price of \$2,185,500, right?

A. That sounds right, yep.

Q. That was for all phases, though, right?

A. For the one and only phase that they had awarded the contract for, yes.

Q. You said before, you anticipated that that work would all get wrapped up before the end of 2014, and you were paying Quinn Emanuel over \$2 million for the work they did, giving you a gut check on the audit between July, when you claim they started work, and the end of 2014, when you said the audit would be over?

A. I think that mischaracterizes some things. Would you like me to explain why?

Q. No. And then it says, "Funding for each of the phases is dependent on the litigation schedule of the government, the court's scheduling, if required, appeals, settlements, and/or final disposition of the taxpayer

02:26:52PM 1 case." Is it your sworn testimony that this is all just
02:26:55PM 2 boilerplate, and there was nothing contemplated other than
02:27:00PM 3 that work in Phase I?

02:27:03PM 4 A. Let me be very clear. There was only one phase
02:27:06PM 5 awarded. You have that. It is limited to examination
02:27:09PM 6 support. There is a schedule before this that specifies
02:27:12PM 7 hours that -- under this not-to-exceed limit on this page.
02:27:16PM 8 That is only one phase.

02:27:17PM 9 My understanding -- and I am not responsible for the
02:27:20PM 10 final contracting, but my understanding is that
02:27:22PM 11 contracting officers work off of templates. And they are
02:27:25PM 12 doing a lot of cutting and pasting. And I know for a fact
02:27:30PM 13 that this contracting officer works with experts at the
02:27:33PM 14 trial stage, and also at the examination stage.

02:27:35PM 15 And, frankly, particularly when comparing this to the
02:27:40PM 16 Boies Schiller contract, this has a lot of sloppy language
02:27:43PM 17 in there that looks like it is artifacts or copy-and-paste
02:27:46PM 18 errors that should not apply here. Quinn Emanuel was not
02:27:49PM 19 hired to be an expert witness, and that phrase doesn't
02:27:53PM 20 appear in the Boies contract.

02:27:54PM 21 Q. I have to ask you to stop. I don't have that much
02:27:57PM 22 time, and you are not responding.

02:27:58PM 23 Over on "period of performance," you say that
02:28:01PM 24 Phase I was going to end at the end of 2014, but the
02:28:05PM 25 contract extended through the end of 2016. Do you see

02:28:10PM 1 that?

02:28:10PM 2 A. I didn't say Phase I was the end. If you went to F-6
02:28:14PM 3 you will see what I saw as -- First of all, this, while
02:28:17PM 4 we are looking at this, this clearly has typos in it.
02:28:21PM 5 Someone has this period of performance right in the middle
02:28:23PM 6 of this other paragraph, and the sentences don't make
02:28:25PM 7 sense. So there is clearly something going on in there
02:28:28PM 8 that has got some editing artifacts. If you go to F-6,
02:28:32PM 9 which on the next page, it actually says the period of
02:28:34PM 10 performance is through December 31st of 2015. And it
02:28:37PM 11 describes one phase. And right below this, F-5, it
02:28:40PM 12 actually says 18 months. And if you add 18 months to when
02:28:44PM 13 the contract was awarded, that actually gets you, roughly
02:28:48PM 14 speaking, to December of 2015, not 2016. So this
02:28:52PM 15 obviously could have been drafted better. If you look at
02:28:55PM 16 F-6, that's what I understood the schedule to be, which is
02:28:58PM 17 on the next page of this contract.

02:29:00PM 18 Q. Time is running short, so I will try to cut to the
02:29:03PM 19 chase here. The truth is that -- with Quinn Emanuel, the
02:29:11PM 20 deal was that if and when this got to the tax court, Quinn
02:29:21PM 21 Emanuel was committed to being trial counsel in the tax
02:29:25PM 22 court, but the IRS retained the authority to say we don't
02:29:30PM 23 want you after all; isn't that true?

02:29:33PM 24 A. There is no obligation under this contract for that
02:29:36PM 25 to happen, but the IRS -- as we mentioned, we sort of

02:29:40PM 1 contemplated that we might get to tax court; and if we
02:29:43PM 2 did, we might want Quinn Emanuel to assist. If that did
02:29:46PM 3 happen, it would have to be subject to a new contract.
02:29:48PM 4 Those were certainly consistent with the discussions we
02:29:51PM 5 had early on.

02:29:51PM 6 Q. You are awfully familiar with every page of this
02:29:55PM 7 contract. Don't you know that this contract says that
02:30:00PM 8 Quinn Emanuel commits that they will act in the capacity
02:30:04PM 9 of special government employee, which is something they
02:30:08PM 10 would have to do to be in the tax court, that they will
02:30:11PM 11 resolve all conflicts in order to be able to get into the
02:30:15PM 12 tax court, and that the contract is non-severable on these
02:30:23PM 13 different stages, and that Quinn Emanuel must agree to act
02:30:29PM 14 in the tax court, but you have the right to say you don't
02:30:31PM 15 want them?

02:30:32PM 16 A. That is actually not what the contract says. It says
02:30:35PM 17 they have to preserve their ability to be special
02:30:37PM 18 government employees. It doesn't require them to. You
02:30:39PM 19 can't force someone to be an employee under a contract.
02:30:42PM 20 That would be a future decision for the IRS. And they
02:30:46PM 21 were preserving the ability to do -- just like we want any
02:30:48PM 22 expert we hire, to make sure that they are available
02:30:51PM 23 wherever a case goes, regardless of whether the audit goes
02:30:54PM 24 to trial or to appeals.

02:30:55PM 25 Q. You do now agree that the contract contemplates not

02:31:01PM 1 just what you call Phase I, but it contemplates at least
02:31:07PM 2 another phase where Quinn Emanuel would be involved in the
02:31:10PM 3 tax court, right?

02:31:12PM 4 MR. WEAVER: Objection. Mischaracterizes
02:31:14PM 5 testimony and the document.

02:31:16PM 6 THE COURT: Overruled. Do you agree or not?

02:31:17PM 7 THE WITNESS: I disagree with that statement.

02:31:20PM 8 By Mr. Beck:

02:31:20PM 9 Q. And you claim that the contract doesn't address
02:31:23PM 10 whether Quinn Emanuel is going to participate in the tax
02:31:27PM 11 court?

02:31:28PM 12 A. It does not say whether they will or won't. It asks
02:31:32PM 13 them to preserve their ability to become special
02:31:34PM 14 government employees and to preserve -- to avoid conflicts
02:31:40PM 15 that may prevent that. There is only one phase of this
02:31:43PM 16 contract. We do not go outside of contracts and perform
02:31:46PM 17 work outside of them. That would be illegal. We would
02:31:48PM 18 have to have a new contract for post-examination support
02:31:51PM 19 if we were paying them hourly. And if we did hire them at
02:31:54PM 20 some point -- Could the IRS say, "We want to hire you as
02:31:57PM 21 special government employees"? Certainly.

02:32:00PM 22 Q. Are there written side deals here that you haven't
02:32:03PM 23 told us about with Quinn Emanuel?

02:32:05PM 24 A. There are no other contracts other than the one you
02:32:07PM 25 have with Quinn Emanuel.

02:32:08PM 1 Q. Now, that makes me a little nervous. I asked for
02:32:11PM 2 "side deals," and you said "contracts." If we asked for
02:32:16PM 3 an engagement letter, you say that is not the same thing
02:32:19PM 4 as a contract. Are there any side deals?

02:32:23PM 5 A. There is no written deals, no. There is nothing
02:32:24PM 6 binding on the IRS, there is nothing binding on Quinn
02:32:27PM 7 Emanuel. I am not sure what your characterization of
02:32:30PM 8 "side deal" is. If you want to give me a definition, I
02:32:33PM 9 will answer your question better.

02:32:34PM 10 Q. You say there is nothing in writing. You had
02:32:36PM 11 discussions with Quinn Emanuel, and you said, "Here is the
02:32:39PM 12 deal, John: We will give you \$2 million as a contractor,
02:32:47PM 13 and you will participate in what we are calling Phase I.
02:32:52PM 14 And then later on, when it comes time for the tax court,
02:32:57PM 15 you are going to have to take a big haircut, because when
02:33:00PM 16 you act as an SGE, you don't get paid very much. But the
02:33:06PM 17 deal is we will front end load it, give you \$2 million for
02:33:09PM 18 Phase I. Later on we will enter into the agreement for
02:33:13PM 19 the tax court, and you are going to have to take a
02:33:17PM 20 haircut." You had those conversations with John Quinn,
02:33:19PM 21 didn't you?

02:33:19PM 22 A. What you just described does not accurately reflect
02:33:22PM 23 any conversations I had with John Quinn.

02:33:23PM 24 Q. Why don't you tell us about the conversations you had
02:33:27PM 25 with John Quinn where you talked about how you were going

02:33:31PM 1 to manage the fact that they later on would be in the tax
02:33:35PM 2 court?

02:33:36PM 3 A. It wasn't "would be," it was a possibility.

02:33:38PM 4 Q. Tell us what you said, what Quinn said.

02:33:41PM 5 A. I can't tell you specifically. But if you are asking
02:33:45PM 6 me about what was the concept, the concept as we
02:33:49PM 7 approached them was, "We would like to get your assistance
02:33:52PM 8 at this examination stage." As reflected in the contract,
02:33:55PM 9 there was two types of assistance we thought we wanted.
02:33:59PM 10 It was, "Give us a gut check, a sounding board on our
02:34:01PM 11 analysis and the taxpayer's, and to the extent new things
02:34:06PM 12 are identified, continue the case on development and
02:34:09PM 13 support." We told them that we hoped to engage the
02:34:12PM 14 taxpayer on resolution. We didn't know if that would be
02:34:14PM 15 successful. Remember, we are talking to them before
02:34:16PM 16 Microsoft says get lost.

02:34:18PM 17 Q. And remember, I asked you about a conversation you
02:34:22PM 18 had concerning how you are going to handle how they get
02:34:25PM 19 hired to come into the tax court?

02:34:27PM 20 A. I am trying to give you the conversation that you
02:34:29PM 21 have asked me about. Then it was, "Well, what happens if
02:34:33PM 22 you don't? What if Microsoft doesn't want to resolve,
02:34:35PM 23 what would you do?" We said, "Well, at that point in time
02:34:38PM 24 the IRS would have to make some decisions. We have
02:34:40PM 25 different options. We could do a 30-day letter, we could

do a 90-day letter, we could do a 90-day letter and designation."

Potentially -- Certainly -- Could this wind up in tax court? Yeah, just like any examination. And at that point in time the IRS would have to say, "We want you to be available. If we are both happy with each other on the front end, maybe we will award another contract for a trial phase."

And initially the concept was that there would be another contract ordered with hourly rates. And it was contemplated at some point in time there may be a need for them to become special government employees. But there was potentially, as conceived, examination support under the contract that was awarded. That was all that was awarded. A potential for a new contract if this ever left examination's jurisdiction and went to Counsel's jurisdiction. Counsel has jurisdiction over tax court cases, not the examination side of the IRS.

And then at some even further future point, if a bunch of things fell into place, and the IRS wanted to pursue it, there was a possibility the IRS may say, "Hey, you will need to become an SGE." That was what was discussed.

Q. And if they came in as SGEs, special government employees, they wouldn't be able to charge a thousand dollars an hour, or even what their paralegals charge,

02:35:56PM 1 \$300 an hour, right?

02:35:58PM 2 A. My understanding is that there is caps. I don't
02:36:01PM 3 think it is an hourly wage, though. I don't know
02:36:04PM 4 exactly --

02:36:05PM 5 Q. It is way, way lower. You know that, don't you, sir?

02:36:08PM 6 A. I know they are lower. I am just pointing out I
02:36:11PM 7 don't know how it is calculated.

02:36:14PM 8 MR. BECK: I guess my time is up, your Honor.
02:36:18PM 9 Just for the record, given the length of his answers and
02:36:20PM 10 things, I feel like I was constrained here and didn't get
02:36:26PM 11 to some of the subjects that I would have like to have
02:36:29PM 12 gotten to. On the other hand, I appreciate your patience.

02:36:33PM 13 THE COURT: Thank you, Mr. Beck.

02:36:35PM 14 Mr. Weaver, we will go ahead and take our break for
02:36:38PM 15 our court reporter. When we come back, you can begin your
02:36:42PM 16 examination at that point.

02:50:11PM 17 (Break.)

02:50:11PM 18 THE COURT: Mr. Weaver, you may inquire.

02:50:22PM 19 MR. WEAVER: May I proceed, your Honor?

02:50:23PM 20 THE COURT: You may begin.

02:50:25PM 21 CROSS-EXAMINATION

02:50:25PM 22 By Mr. Weaver:

02:50:28PM 23 Q. Mr. Hoory, could you briefly tell us what the
02:50:31PM 24 transfer pricing operations objectives were for the
02:50:34PM 25 Microsoft examination when you came into the picture in

late 2011?

A. It was really to take another look at the facts, to consider the items like with the taxpayer Veritas, about us being arbitrary and capricious, not addressing the right facts, and to take a closer look at the residual profit split model that Microsoft used in its valuation to see whether if the inputs were reasonable or not, to see if we could apply it in a more reasonable manner, and also recognizing that there was an interaction between the technology transfer price that was paid by the United States to Puerto Rico and the buy-in that Puerto Rico paid to the United States. We wanted to test the transfer price as well.

So regardless of our methodology for the outbound transfer of intangibles, we knew it was impacted by the transfer price on the inbound sale of the technology IP by Puerto Rico. We knew that the RPSM model impacted the transfer price on the inbound sale by Puerto Rico of technology in the United States, and whatever that transfer price, also would impact the value it was before this transaction, or that is set, when the U.S. sold it to Puerto Rico. So we knew the two were related. We needed to test the methodology.

Q. Did you at the outset, when you became involved, seek to resolve issues where possible?

02:52:16PM 1 A. At the outset we certainly raised questions we had,
02:52:20PM 2 and we let the company know on the front end that we
02:52:23PM 3 always were working towards engaging with them to see if
02:52:26PM 4 there was room for resolution, and that we wanted to talk
02:52:29PM 5 to them before developing a final number, when the ink was
02:52:33PM 6 still wet, was the term that Mr. Maruca used.

02:52:37PM 7 Q. Let's turn to Exhibit 16, Page 1, please. Do you
02:52:42PM 8 recognize Exhibit 16?

02:52:43PM 9 A. I do.

02:52:45PM 10 Q. And what is it?

02:52:46PM 11 A. It is the cover letter for the protest that Microsoft
02:52:49PM 12 filed on January 29th (sic).

02:52:51PM 13 MR. WEAVER: Your Honor, I would move the protest,
02:52:53PM 14 Exhibit 16, into evidence.

02:52:55PM 15 MS. EAKES: Your Honor, Microsoft does object to
02:52:58PM 16 that. This is a document that we have been trying to
02:53:00PM 17 resolve issues with respect to redactions. We would
02:53:04PM 18 object to the wholesale admission of it because of the
02:53:07PM 19 remaining issuing unresolved. With respect to No. 16, it
02:53:10PM 20 is my understanding that Mr. Weaver agreed we can take
02:53:11PM 21 that up at a later point. So we would object to its
02:53:14PM 22 admission now. We don't object to the reference to this
02:53:17PM 23 particular page.

02:53:18PM 24 MR. WEAVER: Your Honor, what I would propose, and
02:53:20PM 25 I talked with Mr. Beck about this before I got up here, is

02:53:22PM 1 that we move it into evidence. I am only going to refer
02:53:26PM 2 to three or four pages. This is a long document. And
02:53:28PM 3 that after the document is in evidence, and I want it to
02:53:33PM 4 be in the record, there are four numbers in this document
02:53:36PM 5 that we have agreed to redactions on. Otherwise, you see
02:53:39PM 6 a ton of redactions that we have agreed to, Microsoft
02:53:41PM 7 wanted to make. And if the court will allow us, before we
02:53:45PM 8 make the exhibits public, we will agree to the remaining
02:53:48PM 9 four redactions.

02:53:49PM 10 THE COURT: All right. With that understanding,
02:53:51PM 11 we will go ahead and admit 16, Madam Clerk.

02:53:57PM 12 (Exhibit No. 16 was admitted.)

02:53:57PM 13 By Mr. Weaver:

02:53:57PM 14 Q. Mr. Hoory, let's turn to the part of the protest
02:54:00PM 15 addressing the Americas transaction, page 37 of Part 3,
02:54:05PM 16 please. What you will see referred to here is a reference
02:54:14PM 17 to Veritas in the protest. Do you recall that Mr. Hoory?

02:54:18PM 18 A. I do.

02:54:18PM 19 Q. How did this reference -- and if we were to look
02:54:22PM 20 through pages a repeated reference -- to Veritas impact
02:54:24PM 21 the way that the exam was going to be conducted going
02:54:27PM 22 forward?

02:54:27PM 23 A. We basically are responding to the concerns I
02:54:31PM 24 discussed with Veritas earlier. We knew we needed to
02:54:35PM 25 really kick the tires, make sure we developed the facts

02:54:37PM 1 and circumstances correctly, and respond to some of the
02:54:40PM 2 allegations here about the IRS being arbitrary and
02:54:43PM 3 capricious. We also knew that we needed to actually look
02:54:46PM 4 at the inputs into the residual profit split model that
02:54:50PM 5 Microsoft had used, and to test them fully.

02:54:52PM 6 Q. Let's turn to Page 61 of Part 3, please. Look at the
02:55:03PM 7 heading here, "The Service's buy-in determination is
02:55:06PM 8 arbitrary, capricious and unreasonable." Did the
02:55:14PM 9 characterization of the audit work as arbitrary and
02:55:17PM 10 capricious have an impact on how the audit was going to
02:55:20PM 11 proceed?

02:55:18PM 12 A. It certainly did. It meant we really had to look at
02:55:20PM 13 the facts and circumstances and bring in the expertise we
02:55:23PM 14 needed, in this case, software industry expertise.
02:55:26PM 15 Because prior to this, just like we did in Veritas, all we
02:55:30PM 16 had was an economist, with no industry experts.

02:55:33PM 17 Q. Now, let's turn to Page 45. And if you could blow up
02:55:39PM 18 Footnote 90, please. I will start reading from here. "As
02:55:49PM 19 support, the Service cites internal memoranda summarizing
02:55:53PM 20 non-transcribed interviews of Microsoft employees from the
02:55:56PM 21 2000 to 2003 audit and resulting MITRE expert report
02:56:02PM 22 opining that software had perpetual useful lives if
02:56:07PM 23 'maintenance' R&D were performed. Such evidence is of
02:56:11PM 24 question utility," et cetera. Mr. Hoory, did this have
02:56:14PM 25 any impact on how you wanted to proceed?

02:56:16PM 1 A. Certainly. We knew that if we did have to rely on
02:56:19PM 2 statements by Microsoft, that we would have to get them on
02:56:21PM 3 the record if they were important or material, and if they
02:56:25PM 4 were in areas that we were unable to resolve issues with
02:56:28PM 5 the company.

02:56:28PM 6 Q. Now, let's turn to Page 18 of this part of the
02:56:31PM 7 protest, and look at the top part of the page, please.
02:56:37PM 8 Let's blow up that top paragraph. It talks about taxpayer
02:56:43PM 9 engaging KPMG to value certain things with respect to the
02:56:49PM 10 buy-in license. And then if you go on down, it also
02:56:52PM 11 refers to KPMG determining a transfer price. What was
02:56:59PM 12 your understanding when you read this early in the audit,
02:57:04PM 13 when you were involved, 2011/2012, of the role that KPMG
02:57:08PM 14 was playing in this audit?

02:57:10PM 15 A. My understanding was that KPMG was responsible for
02:57:13PM 16 preparing the valuation that Microsoft relied on to set
02:57:16PM 17 the arm's length price for both the outbound sale of
02:57:20PM 18 technology rights to Puerto Rico, and then for the inbound
02:57:23PM 19 sale of technology IP to the United States.

02:57:25PM 20 Q. Now, let's digress very briefly. If you can put
02:57:29PM 21 Exhibit 18 up, please? Mr. Hoory, I am referring you to
02:57:40PM 22 Exhibit 18. Do you recognize the numbers on this diagram?

02:57:42PM 23 A. I do. They are my understanding of KPMG's valuation,
02:57:47PM 24 the numbers they arrived at.

02:57:48PM 25 Q. And you pulled these numbers from where?

02:57:49PM 1 A. I pulled them from the KPMG model, including their
02:57:54PM 2 structured rate analysis.

02:57:55PM 3 Q. And were these numbers, with one correction, in your
02:57:58PM 4 declaration?

02:57:59PM 5 A. There was. In my declaration I had transposed the
02:58:02PM 6 15.56 billion for the technology license at the top and
02:58:08PM 7 the 15.35 billion for the R&D funding.

02:58:11PM 8 Q. Recognizing that our time is limited, could you tell
02:58:14PM 9 me --

02:58:15PM 10 Well, first, I will move this into evidence, your
02:58:18PM 11 Honors, as a demonstrative.

02:58:21PM 12 MR. BECK: Well, your Honor, demonstratives don't
02:58:22PM 13 get received in evidence, they are just demonstratives.

02:58:26PM 14 THE COURT: That's fine.

02:58:29PM 15 By Mr. Weaver:

02:58:29PM 16 Q. Let's take a look at the bottom gray part. Can you
02:58:31PM 17 explain the flow of what is going on here in terms of what
02:58:35PM 18 is represented?

02:58:35PM 19 A. Sure. So on the left you have Microsoft Corporation,
02:58:38PM 20 that is the U.S. parent and its U.S. affiliates. In the
02:58:42PM 21 bottom, the oval, you have the third parties. That's
02:58:44PM 22 where they collect the money from. So these are people
02:58:47PM 23 that are not related to Microsoft, other large
02:58:50PM 24 corporations and entities, some resellers, some
02:58:52PM 25 redistributors. The only person or the only entities that

02:58:55PM 1 have these third-party contracts, that enter into
02:58:57PM 2 contracts with these third parties, it is Microsoft U.S.
02:59:01PM 3 Before and after this transaction, those third-party
02:59:03PM 4 relationships collecting the money, is through the United
02:59:06PM 5 States affiliates, not Puerto Rico.

02:59:08PM 6 Q. Very briefly, can you describe the green arrows going
02:59:13PM 7 to and from Microsoft U.S. and Microsoft Puerto Rico?

02:59:16PM 8 A. Sure. So in the green you have a technology license
02:59:19PM 9 from the United States of software code rights to
02:59:22PM 10 Puerto Rico. Puerto Rico agrees to pay the United States
02:59:26PM 11 15.56 billion, not immediately, but in the future, as a
02:59:30PM 12 percentage of future sales. In the red, in the middle,
02:59:33PM 13 you have Puerto Rico agreeing to pay the R&D associated
02:59:37PM 14 with software code thereafter. Over the next ten years
02:59:41PM 15 they are expected to pay 15.35 billion. So those
02:59:45PM 16 numbers -- they are both what they expected to pay the
02:59:47PM 17 U.S. and what they expect in the next ten years.

02:59:50PM 18 Q. This is what KPMG projected in its model?

02:59:54PM 19 A. Yes, it is the numbers they based their valuation on.

02:59:57PM 20 Q. What are the blue lines at the bottom there?

02:59:59PM 21 A. The bottom in blue you have -- Remember, Microsoft
03:00:04PM 22 U.S., they are the ones that are selling everything to
03:00:06PM 23 third parties. They are the only ones with the
03:00:09PM 24 third-party licenses and royalties. So the United States
03:00:11PM 25 agrees to remit to Puerto Rico a percentage of every

dollar they collect, about 55¢ on the dollar, roughly.

And they are basically paying Puerto Rico as the treater (sic) of the software code that Puerto Rico just bought. So it is a roundtrip. You have Puerto Rico buying software code rights, agreeing to pay for R&D, it adds up to about 30 billion. And over the next ten years -- And that is over ten years, too. And then over the next ten years the U.S. plans to turn around and pay Puerto Rico about 67.8 billion for the software code that Puerto Rico is treated as owning. The net impact of all this is, over ten years, Microsoft expected to report \$38 billion less in taxable income in the United States. Instead, that income would be sitting in Puerto Rico where it is not taxed, at least for domestic tax purposes.

Q. Now, with the aid of this diagram can you very succinctly describe for the court the primary area of information that you are still seeking in this audit to get to the right number?

A. So we are looking for the revenue, and information about the revenue and expense it puts on this, and the split between technology intangibles as the software code on the one hand, and non-technology intangibles on the other. So we are talking about the customer relationships, the trademarks. The United States has all the non-technology intangibles after this deal, and

Puerto Rico has purchased the software codes. So you need to know what the relative amounts are. That impacts --

Q. Why do you need to know the relative amounts?

A. You need to know the relative amounts because Puerto Rico is paying the United States for the value of the software code they purchased. Obviously, depending on how important software code is to their business, it could be worth more or less than the buy-in. It is also critically important in the bottom under the technology transfer price --

Q. You are talking about the 67 billion transfer price?

A. I am. That 68 billion, that is supposed to be reflective of how valuable the software code is to the business. If marketing intangibles, if customer relationships, if all these things that Microsoft does, the corporation in the United States, are more important, then that 67.8 billion should go down. So we are looking at the inputs, revenues, and expenses that KPMG used to model this and the assumptions they made.

Q. Back to 2012. During the first part of 2012, did you hire a number of industry experts to take a look at this transaction?

A. We did. For the first time we brought on a number of software industry experts, a marketing expert, and a finance expert. Previously all we had was an economist.

03:02:42PM 1 We also had an outside economist expert as well to help us
03:02:45PM 2 with this, look at KPMG's process.

03:02:48PM 3 Q. Now, we are not going to look at it in any detail,
03:02:51PM 4 but was there another transfer pricing arrangement that
03:02:53PM 5 you were also looking at?

03:02:55PM 6 A. There was. They had a deal in the Asia Pacific
03:02:58PM 7 region. A difference between the Asia Pacific region and
03:03:01PM 8 the United States is the U.S. is a roundtrip. They sell
03:03:04PM 9 something out of the U.S. and immediately they buy it back
03:03:06PM 10 for more. In Asia Pacific they sold everything to their
03:03:09PM 11 foreign affiliate. However, the split between technology
03:03:13PM 12 and non-technology is still at issue there because of some
03:03:17PM 13 positions that Microsoft took. Basically we need to know
03:03:20PM 14 what the split is there as well, because they took the
03:03:22PM 15 position, which we don't necessarily agree with, that all
03:03:27PM 16 of the -- in fact, I believe, 95 percent of non-technology
03:03:30PM 17 was owned by their foreign affiliate. So they didn't have
03:03:34PM 18 to pay for that. We don't think the foreign affiliate
03:03:37PM 19 owned that much, and we also are also questioning the
03:03:40PM 20 split there as well.

03:03:41PM 21 Q. Now, in early 2012, did TPO withdraw the notice of
03:03:45PM 22 proposed adjustments?

03:03:46PM 23 A. We did.

03:03:46PM 24 Q. Did you tell Microsoft, of course?

03:03:48PM 25 A. We did before doing so, and at the time we did.

03:03:52PM 1 Q. And did Microsoft agree to further extensions of the
03:03:55PM 2 statute?

03:03:55PM 3 A. They did agree to extend the statute.

03:03:57PM 4 Q. All right. Let's turn very briefly to Exhibit 15.
03:04:04PM 5 Do you recognize Exhibit 15?

03:04:05PM 6 A. Yes. It is a Duff & Phelps report prepared for
03:04:09PM 7 Microsoft.

03:04:09PM 8 Q. Did you get it as part of the audit?

03:04:11PM 9 A. We got it after we reopened the audit, effectively.
03:04:15PM 10 It was a December IDR, December of 2012. It is one of the
03:04:18PM 11 first questions we asked them when we started to look at
03:04:21PM 12 the facts and circumstances more closely.

03:04:23PM 13 Q. Did you get the backup for it?

03:04:25PM 14 A. Not initially. We asked for all documents, and we
03:04:29PM 15 wound up having to issue a follow-up IDR, because all we
03:04:33PM 16 got was the report, none of the cross-referenced
03:04:35PM 17 attachments.

03:04:35PM 18 Q. So they didn't give you all you needed the first
03:04:37PM 19 time?

03:04:37PM 20 A. Not immediately. We eventually got it.

03:04:41PM 21 MR. WEAVER: I would move this Exhibit 15 into
03:04:43PM 22 evidence, your Honor.

03:04:45PM 23 MR. BECK: Your Honor, here our objection is not
03:04:49PM 24 as to specific redactions, it really goes to what
03:04:52PM 25 Ms. Eakes addressed in her opening statement. This has

nothing to do with the issue before the court, which is was Quinn Emanuel -- should these summonses be enforced, and can Quinn Emanuel take sworn testimony. This is in fact exactly what the IRS warned would happen if somebody dared to oppose them, that they would make a big showing and introduce evidence that has nothing to do with the subject matter of the hearing, but is calculated to inflame by painting us in a bad light. So that is our objection, your Honor.

THE COURT: Mr. Weaver, how is this relevant?

MR. WEAVER: This is relevant, your Honor, because all morning we heard about how Quinn Emanuel has only been hired to prepare this case for tax court. I am leading up to how we still need information, with this foundation. This is a foundation.

I am also going to get to in a minute things that have come in through the summonses that weren't disclosed to the IRS before. It just goes to the point that this case is not being prepared -- the summonses are not to prepare the case for tax court, we need legitimate information. And I want to build that record.

MR. BECK: Your Honor, this is dated 2006, is it? And he said -- The last question was, we did get the information -- we didn't get it all exactly when we wanted it, but then we got it. And Quinn Emanuel didn't come

03:06:31PM 1 along until May of 2014. And there is no linkage
03:06:37PM 2 whatsoever between the contents of this document and the
03:06:43PM 3 circumstances of the Quinn Emanuel hiring. It is truly
03:06:51PM 4 what was warned about in our opening statement.

03:06:54PM 5 MR. WEAVER: Your Honor, I am laying the
03:06:55PM 6 foundation as to why the IRS needed assistance in this
03:06:59PM 7 audit. There are major things that were suspicious. I am
03:07:03PM 8 about to lay a foundation of why the summonses are
03:07:06PM 9 perfectly legitimate, and why the issuance of those
03:07:08PM 10 summonses had nothing to do with the retention of Quinn
03:07:12PM 11 Emanuel or the regulation.

03:07:13PM 12 THE COURT: All right. The objection will be
03:07:15PM 13 overruled. 15 will be admitted, Madam Clerk.

03:07:20PM 14 (Exhibit No. 15 was admitted.)

03:07:20PM 15 By Mr. Weaver:

03:07:21PM 16 Q. Mr. Hoory, I would now turn your attention very
03:07:23PM 17 briefly to Page 14. Mr. Hoory, there is a number of
03:07:32PM 18 \$30 billion at the bottom there. Can you explain to me
03:07:35PM 19 how this impacted on the audit and your need for
03:07:39PM 20 expertise?

03:07:39PM 21 A. Sure. So this says 30 billion for MACSH, that is
03:07:46PM 22 MOPR's, Puerto Rico's parent. When we look at the backup
03:07:51PM 23 for this, it was prepared using the exact same profit and
03:07:55PM 24 loss forecast that KPMG relied on. This was for tax
03:07:58PM 25 purposes. It used the exact same information, which was

03:08:01PM 1 effective as of July 1st, because that's what the P&L
03:08:04PM 2 started with, July 1, 2005, notwithstanding this was a few
03:08:06PM 3 months later. So this was based on a forecast, the same
03:08:18PM 4 forecast KPMG used for the July 1st, 2005 effective
03:08:33PM 5 valuation. The \$30 billion here is based on the same
03:08:36PM 6 information KPMG used, the same forecast. And it
03:08:39PM 7 basically says that when Duff & Phelps looked at this and
03:08:44PM 8 asked what the right value was for this for a tax
03:08:46PM 9 transaction that occurred nine months later, they said it
03:08:50PM 10 was \$30 billion. Because that information was the same
03:08:53PM 11 information KPMG relied on as of July 1st, 2005, they are
03:08:58PM 12 effectively saying a company that was worth nothing or a
03:09:02PM 13 nominal amount on June 30th, 2005, was worth 30 billion
03:09:06PM 14 one day later.

03:09:07PM 15 Q. And did you want to pursue this through additional
03:09:11PM 16 expertise?

03:09:12PM 17 A. We did.

03:09:12PM 18 Q. Let's move on to Exhibit 41. Mr. Hoory, a few
03:09:28PM 19 minutes ago you described your knowledge about KPMG as
03:09:32PM 20 having done valuation work in connection with the Americas
03:09:36PM 21 transaction. Did there come a time when your view of
03:09:42PM 22 KPMG's role in this transaction that is under audit
03:09:46PM 23 changed?

03:09:46PM 24 A. Yes. Through the summonses that were issued to KPMG,
03:09:51PM 25 and one of the IDRs to Microsoft in the fall of 2014, we

learned that KPMG had also helped them -- at least provided input on structuring the transaction.

Q. And you learned this information essentially within the last year, even though the audit has been going on for a number of years?

A. Correct.

Q. So we are on Exhibit 41. And I will just highlight this. We can blow it up. Quote, "New company won't even have a chart of accounts for probably 18 months. Shadow books necessary." Did that catch your eye when you read this document recently?

A. It did. It seemed to reflect concerns that the Puerto Rican entity that was immediately worth \$30 billion one day later, that when they set this up, it wasn't going to be doing much more for 18 months, and didn't have any accounts.

Q. Let's turn to Page 2. Blow that paragraph up. "What can we do to make this thing real? Notify third parties, at a minimum." It goes on about maybe entering into some sort of insurance. What did this mean to you when you read it?

A. It basically confirmed the bells that had been ringing for us, Puerto Rico doesn't have third-party contacts, it doesn't make sales, and here they are looking at ways they could make -- to make this deal look like it

03:11:21PM 1 is a real business deal as opposed to something that they
03:11:24PM 2 just did for tax purposes.

03:11:25PM 3 Q. Let's go back out and go to the top of the first page
03:11:29PM 4 of this exhibit, please. The first page. This appears to
03:11:33PM 5 be a Microsoft preplanning meeting, March 31, 2005. Do
03:11:37PM 6 you recognize the folks listed at the top there?

03:11:39PM 7 A. I do. They look like the persons from KPMG that were
03:11:43PM 8 performing the valuation for Microsoft.

03:11:45PM 9 Q. And this came in through the summons that -- one of
03:11:48PM 10 the summonses at issue, or the one that preceded that; is
03:11:51PM 11 that correct?

03:11:51PM 12 A. It was. I think we received this, actually, this
03:11:54PM 13 year, from KPMG.

03:11:56PM 14 MR. WEAVER: I would move Exhibit 41 into
03:11:58PM 15 evidence.

03:11:58PM 16 MR. BECK: The same objection, your Honor. There
03:12:00PM 17 has been no linkage whatsoever. It is a mudslinging
03:12:03PM 18 campaign, and it is objectionable.

03:12:08PM 19 THE COURT: Thank you. That will be overruled.
03:12:10PM 20 41 will be admitted.

03:12:12PM 21 (Exhibit No. 41 was admitted.)

03:12:12PM 22 By Mr. Weaver:

03:12:13PM 23 Q. One more, Exhibit 40. Let's turn to Exhibit 40,
03:12:17PM 24 please. Do you recognize Exhibit 40, Mr. Hoory?

03:12:21PM 25 A. I do. It is the second set of notes. This one has

03:12:25PM 1 attendees from Microsoft, as well as KPMG.

03:12:29PM 2 Q. The attendees from Microsoft, are they Microsoft tax
03:12:33PM 3 department folk?

03:12:34PM 4 A. Yes, including David Guenther and Glen Cogswell, two
03:12:38PM 5 of the persons identified at Microsoft as having
03:12:41PM 6 participated in structuring this deal.

03:12:43PM 7 Q. I want to refer you to Page 2 of this document,
03:12:48PM 8 please.

03:12:48PM 9 MR. BECK: Your Honor, before we go on, could I
03:12:51PM 10 just make a foundational objection? I would at least like
03:12:54PM 11 to know when they first received this document.

03:12:57PM 12 THE COURT: Can you answer that, Mr. Hoory?

03:13:00PM 13 By Mr. Weaver:

03:13:00PM 14 Q. Mr. Hoory, do you know when you received this
03:13:02PM 15 document?

03:13:02PM 16 A. This was received in response to the KPMG summons
03:13:06PM 17 that we issued. We had a September summons, and then
03:13:09PM 18 repeated in November. I don't know exactly when this
03:13:15PM 19 Bates number was received. It would have been sometime in
03:13:18PM 20 the fall of 2014, or early -- I'm sorry, fall of 2014 or
03:13:22PM 21 early 2015.

03:13:24PM 22 MR. BECK: That is sufficient for my purposes,
03:13:25PM 23 your Honor. I object. He promised that all of this had
03:13:29PM 24 to do with why they needed to hire Quinn Emanuel. Quinn
03:13:33PM 25 Emanuel was hired long before they even get this document.

03:13:37PM 1 MR. WEAVER: What I said, your Honor, was this has
03:13:39PM 2 to do with the purpose for the summons. It has nothing to
03:13:43PM 3 do with trying to get the tax work.

03:13:45PM 4 THE COURT: All right.

03:13:46PM 5 By Mr. Weaver:

03:13:47PM 6 Q. If we could blow up the paragraph that has to do with
03:13:49PM 7 May '99. Mr. Hoory, can you explain what this paragraph
03:13:59PM 8 means to you?

03:14:00PM 9 A. So here they are talking about technology intangibles
03:14:04PM 10 versus non-technology, which they refer to as marketing
03:14:07PM 11 splits.

03:14:07PM 12 MR. BECK: Your Honor, I have a slightly different
03:14:10PM 13 objection. That is, he now says it has to do with why we
03:14:15PM 14 issued the summons. They got the document after they
03:14:18PM 15 issued the summons. This document came in after Quinn
03:14:24PM 16 Emanuel is hired, after the summons was already issued.
03:14:27PM 17 But they think it makes us look bad. It has nothing to do
03:14:32PM 18 with either of those issues.

03:14:34PM 19 MR. WEAVER: Your Honor, it does --

03:14:34PM 20 THE COURT: It hasn't been moved into evidence
03:14:37PM 21 yet, counsel. Let Mr. Weaver lay his foundation for his
03:14:40PM 22 questions. If he moves it into evidence, then we can
03:14:44PM 23 discuss it at that point in time.

03:14:45PM 24 MR. WEAVER: Thank you, your Honor.

03:14:47PM 25 By Mr. Weaver:

03:14:47PM 1 Q. Mr. Hoory, what was your understanding when you
03:14:49PM 2 received this document, about this paragraph?

03:14:50PM 3 A. So my understanding was that the persons at this
03:14:54PM 4 meeting were concerned because they had different splits
03:14:58PM 5 between technology and non-technology in the prior cost
03:15:02PM 6 sharing arrangements that they performed for Europe, the
03:15:05PM 7 Middle East, and Africa, two of those, and the one in
03:15:08PM 8 Asia, versus what they were looking to do in the Americas.
03:15:12PM 9 There were inconsistencies in their technology and
03:15:14PM 10 non-technology splits, the same split that we wanted
03:15:18PM 11 information to more reliably determine.

03:15:20PM 12 Q. What is the split that you understand KPMG to have
03:15:24PM 13 used in the Americas transaction?

03:15:25PM 14 A. So in the Americas transaction, if you look at the
03:15:28PM 15 entire timeframe, it is approximately 78 percent towards
03:15:32PM 16 technology, and, using the terminology the taxpayer used
03:15:35PM 17 here, about 22 percent towards marketing.

03:15:38PM 18 Q. And is that inconsistent with what you are looking at
03:15:41PM 19 here in this 2005 meeting document?

03:15:44PM 20 A. It is. Here they have much more -- at least some of
03:15:47PM 21 them are much more favorable towards non-technology, for
03:15:52PM 22 instance, 55 percent tech versus 45 non-tech.

03:15:57PM 23 Q. Is trying to get down to the bottom of how much to
03:16:00PM 24 allocate to technology versus non-technology at the core
03:16:04PM 25 of most of the pending summonses requests --

03:16:07PM 1 **A. Absolutely. It is central to the outbound sale of**
03:16:10PM 2 **software code, and to the inbound payments from -- I'm**
03:16:16PM 3 **sorry, not inbound. The outbound sale and inbound**
03:16:20PM 4 **payments by Puerto Rico, and then the transfer price that**
03:16:23PM 5 **the United States pays Puerto Rico, that 68 billion. If**
03:16:27PM 6 **technology is too high, the U.S. is paying Puerto Rico too**
03:16:31PM 7 **much, and there is too little income reported in the**
03:16:33PM 8 **United States.**

03:16:34PM 9 **MR. WEAVER: Your Honor, I will move on. First,**
03:16:36PM 10 **let me move for this exhibit's admission into the record.**

03:16:39PM 11 **MR. BECK: We object, your Honor. Quinn Emanuel**
03:16:42PM 12 **was hired in May of 2014, the designated summons issued, I**
03:16:52PM 13 **believe, October 30, 2014. This witness said that this**
03:16:59PM 14 **document was received in November or December. That's**
03:17:02PM 15 **after Quinn Emanuel is hired. It had nothing to do with**
03:17:05PM 16 **that. It was after the designated summons issued. It had**
03:17:11PM 17 **nothing to do with that. It is totally irrelevant, and it**
03:17:16PM 18 **is part of what looks pretty clearly like a calculated**
03:17:19PM 19 **effort to disclose confidential information they think**
03:17:24PM 20 **will make us look bad in retaliation for us daring to**
03:17:28PM 21 **oppose the IRS.**

03:17:30PM 22 **MR. WEAVER: Your Honor, if I may? We agreed to**
03:17:33PM 23 **the redactions Microsoft wanted to make in this exhibit.**
03:17:37PM 24 **What this goes to is, we are trying to get this same kind**
03:17:41PM 25 **of information through all of the summons requests that**

03:17:45PM 1 have to do with the Americas transaction. And there are
03:17:48PM 2 things that are just now coming out in 2014 and 2015 that
03:17:52PM 3 completely justify why the requests are pending. That's
03:17:55PM 4 what this goes to.

03:17:56PM 5 THE COURT: All right. 41 will be admitted.
03:18:00PM 6 (Exhibit No. 41 was admitted.)

03:18:00PM 7 By Mr. Weaver:

03:18:01PM 8 Q. Mr. Hoory, let me take you back in time now. You
03:18:05PM 9 went through three timelines earlier today. So can you
03:18:10PM 10 very briefly just tell me why, if you started getting
03:18:17PM 11 experts in 2012, it took all the way until, let's say, the
03:18:23PM 12 fall of 2013 before you were even thinking about being
03:18:27PM 13 ready to talk with Microsoft in that third timeline?

03:18:31PM 14 A. So we needed to learn enough to raise intelligent
03:18:35PM 15 questions and see what we agreed with them on and what we
03:18:39PM 16 didn't. We needed to have our industry expertise, that
03:18:42PM 17 is, our software industry experts, and our financial
03:18:44PM 18 experts, and in particular our software code expert,
03:18:47PM 19 complete their analysis so that they could provide that to
03:18:49PM 20 our economist, and our economist in turn can do the
03:18:53PM 21 modeling, because each of these people play a different
03:18:56PM 22 role, and the economist's work depends on those other
03:18:58PM 23 experts.

03:18:58PM 24 In particular, with respect to the software code
03:19:00PM 25 expert, it took a while for that to be completed. For

03:19:05PM 1 about the first six months or so we were getting new
03:19:08PM 2 reports, new reports that we had not previously gotten
03:19:11PM 3 from the company, on their internal code churn or code
03:19:16PM 4 reuse analyses. So our experts had to talk to the person
03:19:19PM 5 who authored those reports, ask questions, make sure we
03:19:23PM 6 understood them.

03:19:24PM 7 By November of 2012, so about six months in, our
03:19:27PM 8 experts knew enough to begin to request what source code
03:19:30PM 9 they wanted to look at to measure reuse. So code reuse
03:19:35PM 10 was something that KPMG cited in their evaluation as one
03:19:39PM 11 of their rationales for their short useful life there,
03:19:43PM 12 which impacts the valuation. Our expert needed to look at
03:19:46PM 13 software code.

03:19:47PM 14 And then from November, for several months, there were
03:19:50PM 15 delays where we went back and forth with the company about
03:19:52PM 16 where and under what conditions our software code experts
03:19:56PM 17 would be allowed to look at the software code. Eventually
03:19:59PM 18 those were resolved. Our expert was not able to complete
03:20:01PM 19 their analysis until the end of August in 2013.

03:20:05PM 20 Q. Let me stop you there. The software code expert,
03:20:08PM 21 upon which other experts were going to use as input, was
03:20:13PM 22 done in the fall of 2013?

03:20:15PM 23 A. Yeah. They completed looking at the code in, I
03:20:17PM 24 think, August, and then they had to have some time to
03:20:20PM 25 prepare their analysis so we could give it to the

03:20:22PM 1 economist.

03:20:22PM 2 Q. Now, was it your intention to try to then present the
03:20:26PM 3 findings of these experts to Microsoft to resolve issues,
03:20:29PM 4 or at least narrow them?

03:20:30PM 5 A. Absolutely. That was the meeting that is reflected
03:20:33PM 6 on all of the timelines.

03:20:34PM 7 Q. And because I am not sure it is in the record yet,
03:20:37PM 8 did you also want to retain an outside commercial
03:20:39PM 9 litigator to help evaluate the case before you made that
03:20:43PM 10 presentation?

03:20:43PM 11 A. That was the initial attempt for Boies Schiller. By
03:20:48PM 12 the time we got looking at Quinn Emanuel, that was
03:20:52PM 13 impractical. Initially we wanted that input before we
03:20:54PM 14 went to Microsoft so that we could have an independent
03:20:57PM 15 analysis and gut check.

03:21:00PM 16 Q. And can you recall when the Boies Schiller contract
03:21:05PM 17 that never got worked on was entered into, roughly?

03:21:08PM 18 A. I think it was awarded sometime towards the end of
03:21:13PM 19 fiscal year 2011.

03:21:15PM 20 Q. You mean 2013?

03:21:17PM 21 A. Yes. I'm sorry, 2013. I don't remember the exact
03:21:20PM 22 month. On or about like June 2013, thereabouts.

03:21:23PM 23 Q. Well, for non-governmental people, end of fiscal
03:21:28PM 24 year --

03:21:28PM 25 A. September. The end of the fiscal year is September.

03:21:31PM 1 So sometime between June and September that contract was
03:21:33PM 2 awarded.

03:21:34PM 3 Q. And just in a sentence or two, why was no work done
03:21:40PM 4 on that contract?

03:21:40PM 5 A. No work was done because we were unable to clear a
03:21:43PM 6 conflicts of interest issue.

03:21:45PM 7 Q. Now, did -- after the government shutdown that you
03:21:49PM 8 mentioned earlier today, did you in fact meet with
03:21:52PM 9 Microsoft and try to resolve outstanding issues?

03:21:55PM 10 A. We did. We met with them, presented our preliminary
03:21:58PM 11 analysis for them on January 14th, and suggested a number
03:22:01PM 12 of areas where we had open questions, and thought we
03:22:04PM 13 needed more information, and wanted to engage with them.

03:22:07PM 14 Q. If I could have Exhibit 14 up, please. Do you
03:22:18PM 15 recognize Exhibit 14?

03:22:19PM 16 A. I do. It is the presentation I delivered on
03:22:22PM 17 January 14th, 2014.

03:22:25PM 18 MS. EAKES: Your Honor, if I may. We do have
03:22:27PM 19 continuing issues with respect to 14, as well, as it
03:22:31PM 20 relates to redactions. So if Mr. Weaver is in agreement
03:22:35PM 21 with respect to 16 -- We would like to make sure that is
03:22:38PM 22 what the agreement is before they go into this document.

03:22:40PM 23 MR. WEAVER: Yes, your Honor. It is not my plan,
03:22:43PM 24 hopefully, to refer to the page that is not agreed.

03:22:46PM 25 THE COURT: All right.

03:22:47PM 1 By Mr. Weaver:

03:22:47PM 2 Q. Mr. Hoory, I think you said you did recognize this.
03:22:50PM 3 This was part of the presentation?

03:22:51PM 4 A. Absolutely.

03:22:52PM 5 Q. Let's turn to Page 22. So with the benefit of this
03:23:01PM 6 page, can you in very short order tell me where the areas
03:23:07PM 7 of discussion were with respect to revenues?

03:23:11PM 8 A. So on revenues -- These are financial inputs in the
03:23:14PM 9 valuation model. Microsoft assumed very low growth rates
03:23:18PM 10 for tax purposes, about four percent, for example, in
03:23:21PM 11 2006. In their SEC reporting they were saying ten to
03:23:25PM 12 twelve percent, approximately. That was a large
03:23:27PM 13 difference. Also, in this CAGR, or compounded annual
03:23:31PM 14 growth calculation error -- they had math errors.

03:23:35PM 15 Q. How much was the math error over time?

03:23:37PM 16 A. Over time it understated -- if you believe everything
03:23:40PM 17 else, it understated revenues by approximately
03:23:43PM 18 \$15 billion.

03:23:44PM 19 Q. Can you briefly tell me, very briefly, about where
03:23:51PM 20 the areas were for expenses that you wanted to discuss?

03:23:57PM 21 A. For expenses, we had to allocate worldwide expenses
03:24:00PM 22 to the region and to the retail channel, what was
03:24:03PM 23 applicable for this deal. We found some math errors
03:24:07PM 24 there, some distortions. There was also open questions
03:24:10PM 25 about how to identify geographic revenues and expenses

03:24:14PM 1 that we hoped to engage with them on.

03:24:16PM 2 Q. Last, what did you mean by writing, "Deal of the
03:24:20PM 3 century return on investment"?

03:24:23PM 4 A. This is what our financial expert who worked on Wall
03:24:26PM 5 Street said. He looked at the return that MOPR,
03:24:29PM 6 Puerto Rico that is, was expected, and it was over
03:24:33PM 7 200 percent per year. He said that's unheard of. Maybe
03:24:38PM 8 not for a start-up company, but certainly for an
03:24:41PM 9 established company with an established business as a new
03:24:43PM 10 investor.

03:24:47PM 11 Q. Now, during the meeting, who was there for Microsoft?

03:24:51PM 12 A. So they had, I believe, four attorneys from Baker
03:24:54PM 13 McKenzie, which was Jim O'Brien, Salim Rahim, Paul Schick,
03:25:01PM 14 and John Peterson. There was Bill Sample, and Mike
03:25:05PM 15 Bernard, as well as, I believe, Molly Vlahovich, and David
03:25:08PM 16 Guenther, and Tracy Neighbors from Microsoft.

03:25:11PM 17 Q. Who ended up asking most of the questions at your
03:25:14PM 18 resolution meeting?

03:25:15PM 19 A. Most of the questions were posed by Baker & McKenzie
03:25:19PM 20 attorneys.

03:25:19PM 21 Q. What happened after this meeting?

03:25:21PM 22 A. After this meeting, we initially broke (sic) with
03:25:23PM 23 them, shook hands. They said they had to think a little.
03:25:27PM 24 They promised us feedback within 30 to 60 days, at least
03:25:29PM 25 on the mechanical issues. Eventually, after going back

03:25:32PM 1 and forth a little, in mid to late February, Mr. Sample
03:25:36PM 2 said he wasn't sure that we could meet; he didn't think we
03:25:39PM 3 could do global resolution, but they were still committed
03:25:42PM 4 to giving us 60-day feedback. Through March, April and
03:25:46PM 5 May, it was sort of a hot/cold message from the company.
03:25:49PM 6 Sometimes it was, "We can't talk to you on anything." At
03:25:51PM 7 other times, "Oh, we will still talk to you on these
03:25:54PM 8 things." For example, in May we were still talking about
03:25:56PM 9 engaging on the revenue and expense systems that input the
03:26:02PM 10 dollars and cents for these valuation models. We shared
03:26:06PM 11 an outline with them. And they said, "We are still
03:26:10PM 12 looking at your stuff, we are still looking at the
03:26:12PM 13 materials you gave us in January, we need more time." I
03:26:15PM 14 told Mr. Bernard and Molly Vlahovich, "Well, we are going
03:26:20PM 15 to have to do interviews. We can't wait a couple more
03:26:22PM 16 months."

03:26:22PM 17 Q. When did you tell them they were going to have to do
03:26:26PM 18 interviews?

03:26:26PM 19 A. Repeatedly. This was specifically focused on May. I
03:26:29PM 20 believe it was the May 1st meeting where we talked about
03:26:32PM 21 that. The next week we issued IDRs actually seeking the
03:26:36PM 22 identity of the persons who were responsible for managing
03:26:39PM 23 their accounting systems, the accounting systems that were
03:26:41PM 24 used to input revenues and expenses. Because if we
03:26:46PM 25 couldn't talk to the tax department in a collaborative

03:26:49PM 1 manner, we needed to talk to the people who held the, I
03:26:52PM 2 guess, keys to the actual systems, the businesspeople.

03:26:54PM 3 Q. Now, let me just back up for a second. You testified
03:26:58PM 4 earlier today that you had an initial meeting with Quinn
03:27:02PM 5 Emanuel for the purposes of seeing if you wanted to retain
03:27:04PM 6 them; is that correct?

03:27:05PM 7 A. That's correct.

03:27:06PM 8 Q. From that point forward, all the way through July 15,
03:27:10PM 9 when you sent information to them, did you have any
03:27:12PM 10 substantive conversations or did you get any advice from
03:27:16PM 11 Quinn Emanuel?

03:27:16PM 12 A. No. The conversations were purely limited to
03:27:20PM 13 procedural issues, logistics, about the contracting
03:27:23PM 14 process.

03:27:24PM 15 Q. Now, I think it is in one of Microsoft's
03:27:28PM 16 declarations, they talk about your issuing five, quote,
03:27:32PM 17 wrap-up IDRs in the first few months of 2014. Did you
03:27:37PM 18 consider those to be wrap-up IDRs?

03:27:40PM 19 A. I considered them to be IDRs on open issues.

03:27:43PM 20 Q. And did there come a time when you thought that there
03:27:48PM 21 needed to be follow-up with additional IDRs?

03:27:51PM 22 A. Yes. Basically we focused initially -- I think only
03:27:56PM 23 four of those five were focused on pure transfer pricing
03:28:01PM 24 issues, one or two on Asia Pacific, and the other two were
03:28:04PM 25 seeking the identities of these people, these managers of

03:28:07PM 1 accounting systems, so we could talk to them. And then,
03:28:09PM 2 you know, in July, after Mr. Sample said, "We are not
03:28:13PM 3 going to talk to you on anything at all; just finish your
03:28:15PM 4 audit," then we went back and we issued -- well, actually
03:28:21PM 5 July -- before and after he said that, we were preparing
03:28:25PM 6 IDRs on all the topics that we thought were necessary to
03:28:28PM 7 get to the right split, to get to the right number between
03:28:32PM 8 technology and non-technology. And those were the July
03:28:35PM 9 IDRs.

03:28:35PM 10 Q. I want to focus on the July IDRs. Did you start
03:28:40PM 11 preparing those in May and June, before you had any
03:28:41PM 12 conversations with Quinn Emanuel?

03:28:42PM 13 A. Yes, before I had any substantive conversations with
03:28:44PM 14 Quinn Emanuel.

03:28:45PM 15 Q. Did Quinn Emanuel have any input whatsoever in the
03:28:48PM 16 July IDRs that were issued to Microsoft?

03:28:50PM 17 A. They had absolutely no input whatsoever on the July
03:28:54PM 18 11th IDRs or on the July 18th IDR.

03:28:57PM 19 Q. Did those IDRs essentially ask for some of the same
03:29:00PM 20 information that are being asked for in the pending
03:29:03PM 21 summonses?

03:29:04PM 22 A. They do. They are split up by subject matter. They
03:29:07PM 23 are on subject matters we thought would help us with the
03:29:09PM 24 revenue and expense inputs, or with subject areas that
03:29:14PM 25 would be potentially informative as to the split between

03:29:17PM 1 tech and non-tech.

03:29:18PM 2 Q. And did one of those IDRs ask questions about who
03:29:22PM 3 outside of Microsoft helped plan and draft the Americas
03:29:24PM 4 agreements?

03:29:25PM 5 A. It did. IDR IE-2209 asked about background
03:29:30PM 6 information about the Americas planning.

03:29:32PM 7 Q. And did you get a sufficient response prior to the
03:29:36PM 8 summonses?

03:29:36PM 9 A. We did not receive any documents in response to that
03:29:40PM 10 IDR until, I believe, October 2nd, although the cover
03:29:45PM 11 letter is dated September 30th. And we received
03:29:51PM 12 significant and material new information, that had not
03:29:54PM 13 been previously provided, in response to the summonses.
03:29:57PM 14 We are still seeking additional information.

03:29:59PM 15 Q. Now, the regulation has been referred to here today.
03:30:07PM 16 I just want to ask a follow-up question. You mentioned
03:30:10PM 17 something about Tom Ralph having handled another case that
03:30:17PM 18 you learned about in 2013. Did there come a time in 2014
03:30:22PM 19 when Mr. Ralph and you had some discussion about this
03:30:26PM 20 regulation?

03:30:27PM 21 A. There did. When the regulation was finally
03:30:31PM 22 promulgated and final, Tom took credit for it, and
03:30:35PM 23 jokingly referred to it as, "It shall be known in the
03:30:39PM 24 future as the Ralph Rule." That was the joke between
03:30:41PM 25 those of us in Transfer Pricing Operations.

03:30:44PM 1 Q. Let me turn to the designated summons very quickly.
03:30:59PM 2 That would be Exhibit 13. Do you recognize Exhibit 13?

03:31:08PM 3 A. I do. It is a designated summons issued on
03:31:12PM 4 October 30th.

03:31:13PM 5 MR. WEAVER: Your Honor, I would move that into
03:31:16PM 6 evidence.

03:31:18PM 7 THE COURT: Any objection to 13, counsel?

03:31:21PM 8 MR. BECK: No objection.

03:31:22PM 9 THE COURT: Thank you. Madam Clerk, 13 will be
03:31:25PM 10 admitted.

03:31:28PM 11 (Exhibit No. 13 was admitted.)

03:31:28PM 12 By Mr. Weaver:

03:31:29PM 13 Q. Let me refer you, if I could, Mr. Hoory, to several
03:31:33PM 14 of these requests, several pages in. I think they are on
03:31:36PM 15 Page 8. I will refer you to the requests 14 through 17.
03:31:46PM 16 Can you briefly summarize the kind of information that you
03:31:49PM 17 are seeking in the designated summons in 14 through 17?

03:31:53PM 18 A. So all of these requests focus on forecast or forward
03:31:57PM 19 looking expectations that the company had internally.
03:32:00PM 20 Some of them focus on forecasts or expectations that were
03:32:05PM 21 used for business planning. And 17 specifically focuses
03:32:08PM 22 on the forecasts that we were aware of, that the company
03:32:10PM 23 had previously given us, as having been prepared in
03:32:12PM 24 connection with their tax deal.

03:32:13PM 25 Q. Let's flip very quickly now to Exhibit 28. Do you

03:32:26PM 1 recognize Exhibit 28?

03:32:27PM 2 A. I do. It is an IDR issued back in 2008, seeking
03:32:31PM 3 forecast information relevant to the business groups in
03:32:35PM 4 the Americas that were the subject of the Americas
03:32:38PM 5 cost-sharing arrangement.

03:32:40PM 6 Q. And what is the response from Microsoft here?

03:32:43PM 7 A. The response refers back to an earlier IDR response.
03:32:48PM 8 Basically they are saying, "Go look at the forecast that
03:32:51PM 9 KPMG used," without providing any additional information.

03:32:52PM 10 MR. WEAVER: I would move this exhibit into
03:32:54PM 11 evidence, your Honor.

03:32:59PM 12 THE COURT: Any objection to 28?

03:33:02PM 13 By Mr. Weaver:

03:33:03PM 14 Q. Let's turn to Exhibit 29.

03:33:04PM 15 MR. BECK: No objection.

03:33:05PM 16 THE COURT: 28 will be admitted, Madam Clerk.

03:33:07PM 17 (Exhibit No. 28 was admitted.)

03:33:07PM 18 By Mr. Weaver:

03:33:07PM 19 Q. What is Exhibit 29?

03:33:08PM 20 A. This is a follow-up IDR that I was involved with in
03:33:11PM 21 2013. We were seeking information about the forecast that
03:33:19PM 22 they referred to. That is that 2026 IDR forecast. We
03:33:24PM 23 basically wanted to know, "Hey, did you look at anything
03:33:27PM 24 else for tax purposes? If so, give us a copy of it." And
03:33:30PM 25 we asked if they had any supporting documentation for that

03:33:33PM 1 forecast to explain these low growth rates that they used.
03:33:37PM 2 We also asked who was responsible for preparing that
03:33:39PM 3 forecast for the tax-driven valuation.

03:33:42PM 4 Q. Let's flip to the third page. Did they identify
03:33:50PM 5 someone?

03:33:50PM 6 A. Yes, they basically said that Chris Suh, who was one
03:33:54PM 7 of the people we interviewed in October, prepared it at
03:33:58PM 8 the request of Glen Cogswell, who is also one of the
03:34:01PM 9 people we have issued a summons for, seeking testimony.

03:34:04PM 10 Q. Did they refer you to a particular document here?

03:34:09PM 11 A. They referred to the same document that was provided
03:34:11PM 12 in response to IDR IE-2026. That is the
03:34:21PM 13 2005_0926_MSFT_PL.xls. In response to our request for any
03:34:25PM 14 backup documentation describing anything -- any of the
03:34:27PM 15 assumptions therein, you know, detail on that forecast,
03:34:30PM 16 they say they couldn't find anything -- or that they would
03:34:32PM 17 look.

03:34:32PM 18 Q. Let's go to Exhibit --

03:34:35PM 19 MR. WEAVER: I would move that exhibit into
03:34:37PM 20 evidence, your Honor, 29.

03:34:39PM 21 MR. BECK: No objection.

03:34:40PM 22 THE COURT: Madam Clerk, 29 is admitted.

03:34:43PM 23 (Exhibit No. 29 was admitted.)

03:34:43PM 24 By Mr. Weaver:

03:34:44PM 25 Q. Exhibit 30, please. What is Exhibit 30?

03:34:52PM 1 A. Exhibit 30 was issued at the same time as the
03:34:54PM 2 previous one.

03:34:55PM 3 Q. What does it ask for?

03:34:56PM 4 A. It asks for a forecast, except this time we are
03:34:59PM 5 focusing on business forecasts, the same thing they used
03:35:02PM 6 for their business planning, as well as any tax forecast
03:35:05PM 7 that they prepared, other than the one relied on by KPMG.

03:35:08PM 8 Q. And what is the response?

03:35:10PM 9 A. They say they couldn't find a single forecast of the
03:35:13PM 10 type we described prepared during the entire calendar year
03:35:17PM 11 of 2005.

03:35:18PM 12 Q. All right. Let's move to Exhibit 8.

03:35:22PM 13 MR. WEAVER: First, I would move Exhibit 30 into
03:35:25PM 14 evidence.

03:35:25PM 15 MR. BECK: No objection.

03:35:26PM 16 THE COURT: 30 will be admitted.

03:35:28PM 17 (Exhibit No. 30 was admitted.)

03:35:28PM 18 By Mr. Weaver:

03:35:29PM 19 Q. Let's go to Exhibit 8. What is Exhibit 8?

03:35:31PM 20 A. Exhibit 8 is the interview transcript for our
03:35:33PM 21 interview of Chris Suh, the same person who was identified
03:35:37PM 22 as having prepared the forecast at the behest of the tax
03:35:41PM 23 department. So he is an internal person at Microsoft in
03:35:44PM 24 their -- I think it is their financial planning
03:35:46PM 25 department.

03:35:46PM 1 Q. And who led that interview?

03:35:50PM 2 A. I did.

03:35:50PM 3 Q. And let's turn to Page 99. Can you tell me what is
03:36:01PM 4 going on in this part of the interview, please?

03:36:02PM 5 A. In Lines 5 through 7, and clarified in 10 through 12,
03:36:06PM 6 I am saying, "Hey, has anyone asked you or contacted you
03:36:10PM 7 with respect to this tax project that you did for Glen
03:36:13PM 8 Cogswell, the project that he did to prepare forecasts
03:36:16PM 9 that KPMG could use?" And he says, "No, no one has
03:36:20PM 10 contacted me within the last six months."

03:36:24PM 11 Q. And did you follow up through a summons request for
03:36:27PM 12 this information, the summons request we just looked at a
03:36:30PM 13 few moments ago?

03:36:31PM 14 A. We did. 17 specifically focuses on the forecast that
03:36:36PM 15 Chris Suh prepared. He also says in here, not just the
03:36:39PM 16 last six months, but he can't recall any time in the last
03:36:42PM 17 several years, which would encompass those IDRs we looked
03:36:45PM 18 at, when someone at the tax department reached out to him
03:36:48PM 19 and said, "Hey, do you have any materials related to this
03:36:51PM 20 project?"

03:36:51PM 21 Q. Exhibit 31, please.

03:36:52PM 22 I am only going to refer to the first page here.
03:36:55PM 23 The same deal as the other two things that were not agreed
03:36:58PM 24 to?

03:36:58PM 25 MS. EAKES: You are only going to refer to the

03:37:01PM 1 first page of Page 31? You are not going to move for its
03:37:03PM 2 admission?

03:37:05PM 3 MR. WEAVER: I will move for its admission, but I
03:37:07PM 4 will agree --

03:37:08PM 5 MS. EAKES: To the other redactions --

03:37:09PM 6 MR. WEAVER: That you proposed.

03:37:09PM 7 THE COURT: Hang on. I want to make sure I
03:37:12PM 8 understand. This is the same as No. 16?

03:37:14PM 9 MR. WEAVER: Yes.

03:37:15PM 10 THE COURT: The parties have not fully agreed on
03:37:17PM 11 the redactions, but before it is released, it will be in
03:37:19PM 12 fact -- the agreement will be reached?

03:37:22PM 13 MR. WEAVER: Yes, your Honor, that is correct.

03:37:24PM 14 MR. BECK: We agreed to the first one based on the
03:37:29PM 15 representation that he agrees to the redactions that we
03:37:32PM 16 proposed that they had previously resisted.

03:37:35PM 17 MR. WEAVER: We are agreeing.

03:37:36PM 18 THE COURT: Thank you.

03:37:37PM 19 MR. BECK: So all of our proposed redactions that
03:37:40PM 20 are still in doubt get made?

03:37:42PM 21 MR. WEAVER: As of the last round, yes.

03:37:46PM 22 MR. BECK: Good.

03:37:47PM 23 THE COURT: All right.

03:37:50PM 24 MR. WEAVER: Before I forget, I would move the Suh
03:37:54PM 25 transcript, Exhibit 8, into evidence.

03:37:56PM 1 MR. BECK: We object to that, your Honor. We have
03:37:57PM 2 one page that may be relevant, but it is 100 pages or so
03:38:02PM 3 of a transcript. I can't sit here and tell you what's in
03:38:06PM 4 there and what is not in there. I don't think that
03:38:08PM 5 transcripts typically would get moved into evidence
03:38:11PM 6 anyway. But I don't think there is a need for an entire
03:38:14PM 7 transcript to come in when the subject matter was four or
03:38:19PM 8 five lines of testimony from a particular page.

03:38:22PM 9 MR. WEAVER: Your Honor, there is another reason
03:38:23PM 10 for that transcript going in. And if I have time, which I
03:38:27PM 11 may not, there are other transcripts in some of the
03:38:30PM 12 declarations submitted by Microsoft where they
03:38:33PM 13 cherry-picked a few pages in which John Gordon or another
03:38:37PM 14 Quinn Emanuel attorney asked some follow-up questions.
03:38:39PM 15 But if you look at the whole transcript, some of the
03:38:42PM 16 objecting attorneys for Microsoft are speaking more than
03:38:44PM 17 John Gordon spoke in those interviews. So I do want the
03:38:49PM 18 interviews in the record. And they have been redacted by
03:38:52PM 19 Microsoft. We have agreed to the redactions, to redact
03:38:56PM 20 confidential information. But it shows the volume of
03:38:59PM 21 questions that were asked by Quinn Emanuel as opposed to
03:39:03PM 22 the questions that were asked by IRS.

03:39:05PM 23 MR. BECK: So it is for an entirely different
03:39:07PM 24 purpose than what it was used for in court; we now find
03:39:10PM 25 why he introduces it. And, your Honor, the redactions

03:39:13PM 1 just have to do with information that is confidential
03:39:17PM 2 business information that shouldn't be aired in court. It
03:39:21PM 3 doesn't mean that unredacted material magically becomes
03:39:24PM 4 relevant. And so we've got a large transcript, and I
03:39:30PM 5 don't know all that is in it. If he wants to make a
03:39:33PM 6 rhetorical point about how many people made objections and
03:39:36PM 7 how many people said other things, he can do that in a
03:39:40PM 8 post-hearing submission. But I don't think that an entire
03:39:43PM 9 transcript ought to come into the public record based on
03:39:47PM 10 his representations.

03:39:48PM 11 THE COURT: That's my concern as well, Mr. Weaver.
03:39:51PM 12 I understand your point. I also know that you focused on
03:39:55PM 13 the initial page, and I understood Mr. Hoory's testimony,
03:40:00PM 14 so we are not going to admit anything.

03:40:02PM 15 MR. WEAVER: Fair enough, your Honor.

03:40:04PM 16 By Mr. Weaver:

03:40:05PM 17 Q. Let's move on to Exhibit 31. Mr. Hoory, Exhibit 31,
03:40:09PM 18 do you recognize this document?

03:40:10PM 19 A. I do. It is an email that was produced to us by
03:40:13PM 20 Microsoft, I believe at the end of December, but it has
03:40:17PM 21 Chris Suh on it, Fabien Mousseau. Fabien Mousseau, I
03:40:23PM 22 understand from our interview with Mr. Suh, is someone
03:40:24PM 23 that worked with him and helped him with the forecast and
03:40:27PM 24 the exercise with respect to the Americas.

03:40:28PM 25 Q. December of 2014?

03:40:29PM 1 A. That's when we received this. I think the 31st of
03:40:32PM 2 December, if I recall correctly.

03:40:33PM 3 Q. I am not going to turn to Page 2, but what did you
03:40:38PM 4 learn by receiving this that is relevant to your summons
03:40:41PM 5 requests?

03:40:42PM 6 A. Well, three things: First, there is a note that
03:40:46PM 7 refers to the forecasting exercise prepared for Glen
03:40:49PM 8 Cogswell. And it attaches a fairly robust PowerPoint
03:40:53PM 9 presentation showing a lot of the inputs and assumptions
03:40:56PM 10 that were used in that forecast. I think it is about 30
03:40:58PM 11 pages. So that is all the detail that we were seeking in
03:41:01PM 12 2184 that they said they couldn't find. And even though
03:41:04PM 13 Mr. Suh had this email, he didn't recall having been asked
03:41:08PM 14 for it under his transcript. And now we got it, but only
03:41:12PM 15 after we issued a summons.

03:41:13PM 16 Number two, there is a reference there to conservative
03:41:16PM 17 forecasts. And someone is dressing down another Microsoft
03:41:20PM 18 employee who assumed zero growth. And that is something
03:41:24PM 19 that Microsoft did in the Asia Pacific deal. We were also
03:41:27PM 20 trying to get forecast information. Here, I think it was
03:41:31PM 21 Fabien or Chris Suh, or one of their colleagues says,
03:41:35PM 22 "Zero growth isn't the conservative case, it is the
03:41:38PM 23 abysmal case," is what he says.

03:41:41PM 24 And then, finally, we see that there is actually three
03:41:43PM 25 types of forecasts that they performed: A conservative

03:41:45PM 1 one, which is the lowest one that they performed. And
03:41:48PM 2 that's what they used in their tax valuation. There is an
03:41:51PM 3 intermediate one, which is supposed to track market
03:41:54PM 4 expectations. And then they have a BPR forecast, which is
03:41:58PM 5 the highest one. And that's expectations if they executes
03:42:02PM 6 all of their strategies successfully.

03:42:03PM 7 What we know from this is no growth is an abysmal
03:42:07PM 8 case, not a conservative case; that the conservative case,
03:42:10PM 9 which is something I tried to get information from Mr. Suh
03:42:13PM 10 on but he couldn't recall, is the lowest forecast. And
03:42:15PM 11 they actually had a lot of backup to the forecast exercise
03:42:20PM 12 they performed for the tax department, yet we didn't
03:42:23PM 13 receive it until after we issued a summons.

03:42:24PM 14 Q. And you had been asking for this information for
03:42:26PM 15 years?

03:42:26PM 16 A. Since 2008, effectively.

03:42:28PM 17 Q. Now, we are not going to look at all the exhibits. I
03:42:32PM 18 would like to, but can you tell me what you learned by
03:42:34PM 19 interviewing someone in the fall by the name of Bosco
03:42:37PM 20 Chau?

03:42:38PM 21 A. Mr. Chau was offered by Microsoft as someone who knew
03:42:42PM 22 about their business investment funds, or BIF, B-I-F,
03:42:47PM 23 program. And he characterized BIF investments as a sales
03:42:51PM 24 expense.

03:42:51PM 25 Previously in IDRs we had asked about why KPMG and

03:42:55PM 1 Microsoft classified this BIF expense as routine, as
03:42:59PM 2 expenses that they did not treat as creating any
03:43:01PM 3 intangible value. Leaving those expenses and other costs
03:43:04PM 4 out of those that they would count towards non-technology
03:43:07PM 5 would have had the result of undervaluing the non-tech,
03:43:11PM 6 basically influencing that split. Microsoft's response to
03:43:16PM 7 our IDR said, "We treated those as routine, including
03:43:19PM 8 business investment funds expenses, as routine, because
03:43:22PM 9 they have no benefit beyond one year."

03:43:24PM 10 When we asked Mr. Chau about them, he said, "Actually,
03:43:27PM 11 BIF funds, they are used to recruit new clients, new
03:43:31PM 12 enterprise clients, clients that are relevant to the Asia
03:43:34PM 13 Pacific and the Americas transactions."

03:43:37PM 14 And when we asked him, "If you successfully deployed
03:43:42PM 15 BIF investments, these business investment fund -- proof
03:43:45PM 16 on concept investments, to get a new client, how long do
03:43:47PM 17 you expect them to last?" And his answer was, "Three
03:43:49PM 18 years, because they typically award three-year contracts
03:43:52PM 19 to enterprise partners." That belies the responses in the
03:43:56PM 20 IDRs that said business investment funds have no benefit
03:44:00PM 21 beyond one year.

03:44:00PM 22 Q. And do the summonses at issue seek more information
03:44:03PM 23 about those kinds of sales and marketing programs?

03:44:06PM 24 A. They do. They seek a wide variety of information
03:44:09PM 25 with respect to sales and marketing programs.

03:44:12PM 1 Q. What did you learn by interviewing somebody by the
03:44:15PM 2 name of Hanson?

03:44:15PM 3 A. Robert Hanson, as I recall, he was in charge of their
03:44:19PM 4 market research program. And he had identified three
03:44:21PM 5 classes of market research that he considered large or
03:44:25PM 6 high-profile annual or more often research. It was
03:44:29PM 7 basically customer satisfaction or CPE surveys, brand
03:44:35PM 8 tracking or image-tracking surveys, and then some
03:44:38PM 9 advertising research.

03:44:40PM 10 We had previously sought information about brands, I
03:44:44PM 11 believe it was in IDR IE-2145, initially. And we had a
03:44:50PM 12 follow-up to that because we saw some high-level brand
03:44:52PM 13 studies up through 2000, but none between 2000 and 2009.
03:44:56PM 14 So we asked for those in IDR IE-2168, if I recall
03:45:07PM 15 correctly.

03:45:10PM 16 The response we received from Microsoft was they
03:45:12PM 17 couldn't find them; they thought they were discontinued.
03:45:14PM 18 When we asked Mr. Hanson about them, he said that they
03:45:17PM 19 were performed annually. And we were asking about the
03:45:20PM 20 timeframe between 2000 and 2006. So he described those
03:45:24PM 21 brand -- high-level brand studies as the types of things
03:45:28PM 22 that he remembers being performed regularly, annually or
03:45:31PM 23 more often. Yet we didn't receive any after 2000.

03:45:35PM 24 Q. And the summonses are seeking that kind of
03:45:36PM 25 information?

03:45:37PM 1 A. We are seeking that, and we are also seeking the CPE,
03:45:40PM 2 customer and partner experience surveys, that Mr. Hanson
03:45:43PM 3 mentioned, and that several other persons mentioned as
03:45:46PM 4 having been used to evaluate persons' performance, whether
03:45:50PM 5 they were successfully deploying sales and marketing
03:45:54PM 6 functions on behalf of Microsoft.

03:45:57PM 7 Q. Without telling me any specific advice that you may
03:46:00PM 8 have received from Quinn Emanuel, how would you
03:46:03PM 9 characterize overall, at a high level, Quinn Emanuel's
03:46:07PM 10 impact on the designated summons?

03:46:09PM 11 A. Very, very limited.

03:46:12PM 12 Q. And let's turn to Exhibit 23. Do you recognize
03:46:21PM 13 Exhibit 23?

03:46:22PM 14 A. I do.

03:46:23PM 15 Q. What is it?

03:46:26PM 16 A. It is the summons we issued to KPMG on November 17th
03:46:29PM 17 for information relating to their assistance with
03:46:33PM 18 Microsoft's Americas valuation plan.

03:46:37PM 19 Q. Did Quinn Emanuel have any impact on what was
03:46:40PM 20 requested here?

03:46:41PM 21 A. I don't recall them providing any input on this
03:46:43PM 22 summons.

03:46:45PM 23 MR. WEAVER: I would move this into evidence, your
03:46:47PM 24 Honor.

03:46:47PM 25 MR. BECK: No objection, your Honor.

03:46:48PM 1 THE COURT: Madam Clerk, 23 will be admitted.

03:46:51PM 2 (Exhibit No. 23 was admitted.)

03:46:51PM 3 By Mr. Weaver:

03:46:52PM 4 Q. Exhibit 22, please. What is Exhibit 22, Mr. Hoory?

03:46:58PM 5 A. A summons issued to E&Y, Ernst & Young, on
03:47:02PM 6 November 17th. It is focused on Ernst & Young's role with
03:47:05PM 7 respect to the Asia Pacific transaction.

03:47:07PM 8 Q. And do you recall Quinn Emanuel's input on this
03:47:10PM 9 summons?

03:47:10PM 10 A. Absolutely none whatsoever.

03:47:13PM 11 Q. Let's turn to Exhibit 21.

03:47:19PM 12 MR. WEAVER: I would move Exhibit 22 into
03:47:21PM 13 evidence.

03:47:21PM 14 THE COURT: Any objection to 22, Mr. Beck?

03:47:24PM 15 MR. BECK: No objection.

03:47:25PM 16 THE COURT: Thank you. 22 is admitted.

03:47:29PM 17 (Exhibit No. 22 was admitted.)

03:47:29PM 18 By Mr. Weaver:

03:47:30PM 19 Q. Exhibit 21, please. What is Exhibit 21?

03:47:35PM 20 A. A November 20th summons, a related summons. It is
03:47:38PM 21 following up on the designated summons issued to Microsoft
03:47:41PM 22 Corporation.

03:47:41PM 23 Q. And do you recall the input of Quinn Emanuel on this
03:47:44PM 24 document and the request therein?

03:47:47PM 25 A. I believe this primarily focused on the Asia Pacific

03:47:50PM 1 and some broad categories. And I do not believe Quinn
03:47:53PM 2 Emanuel had any input whatsoever on this summons.

03:47:56PM 3 MR. WEAVER: All right. I will offer this into
03:48:04PM 4 evidence as well.

03:48:04PM 5 MR. BECK: No objection.

03:48:05PM 6 THE COURT: Thank you, counsel. Exhibit 21 will
03:48:09PM 7 be admitted.

03:48:10PM 8 (Exhibit No. 21 was admitted.)

03:48:10PM 9 By Mr. Weaver:

03:48:10PM 10 Q. Exhibit 20, please. What is this?

03:48:15PM 11 A. This is a November 19th summons that we issued to
03:48:19PM 12 Microsoft, a related summons. Its subject matter focused
03:48:23PM 13 in large part on the Asia Pacific, but it had some cleanup
03:48:27PM 14 items with respect to the Americas as well.

03:48:30PM 15 Q. And without revealing any advice that you may have
03:48:34PM 16 received from Quinn Emanuel, did Quinn Emanuel have any
03:48:37PM 17 significant role in the questions asked in this summons?

03:48:40PM 18 A. No. The only input I recall getting from them were
03:48:44PM 19 the typo corrections on this one.

03:48:46PM 20 Q. Now, you have also issued summonses for interviews.
03:48:51PM 21 And I think eight are being enforced here through these
03:48:55PM 22 related actions. Generally, why are you seeking testimony
03:48:59PM 23 of these individuals?

03:49:00PM 24 A. So we are seeking testimony on the same subject areas
03:49:03PM 25 that were identified, effectively. We are seeking

information originally on -- in July. A number of those persons we requested interviews in September and October, but then weren't scheduled by Microsoft.

Q. And where did these names come from?

A. They came from two sources. They were either already identified by Microsoft. And previously requested examples of those would be James Allchin, Jeffrey Raikes, Craig Mundie, David Guenther. We hadn't requested Glen Cogswell, because we didn't then know how much he had to do with the deal. After we saw some of the correspondence that was produced in documents, probably in October, we knew he had a much greater role. So then we asked for him as well, another Microsoft employee.

The remainder were either mentioned in transcripts or we already knew about them and confirmed -- that is, the IRS already knew about them based on our pre-July research, and we decided that we needed to cover some topics that were not sufficiently addressed at the September and October interviews.

Q. Earlier today you were accused of asking for this information in these summonses to essentially prepare for tax court litigation. Is that why these summonses were prepared and the information sought?

A. No. We certainly know there is a possibility that this will wind up in tax court. And, obviously, given the

03:50:34PM 1 state of the exam, that likelihood is obviously higher
03:50:37PM 2 than it might be in another case.

03:50:39PM 3 However, the summons is, just like in any examination,
03:50:42PM 4 they are supposed to help us get to the right number. And
03:50:44PM 5 regardless of the status of an examination, that is always
03:50:47PM 6 our goal at the IRS, and it is here as well, we want to
03:50:50PM 7 get to the right number, something that we can put on a
03:50:53PM 8 stat notice in this case, because we are obviously not
03:50:56PM 9 going the appeals route at this point. At least it
03:50:59PM 10 doesn't look like it is in the cards.

03:51:00PM 11 Q. Why is that?

03:51:01PM 12 A. It is because the number -- we think that the
03:51:04PM 13 valuation relied on by Microsoft was very weak. There is
03:51:08PM 14 no time left on the statute, so we are actually required
03:51:10PM 15 to issue a stat notice.

03:51:15PM 16 Let me be clear. This case has not been designated
03:51:18PM 17 for litigation yet. We are still seeking information to
03:51:20PM 18 get to the right number. But just from my own
03:51:23PM 19 perspective, we think that there are -- it is such a huge
03:51:31PM 20 divergence in numbers, we think it is a very aggressive --
03:51:37PM 21 this roundtrip, particularly in the Americas, the evidence
03:51:41PM 22 of KPMG and/or Microsoft potentially cherry-picking some
03:51:45PM 23 inputs. And we have put a lot of energy into it.

03:51:49PM 24 Just like I told Mr. Bernard leading up -- I think we
03:51:52PM 25 had this conversation in March. I said, "Given the size

03:51:55PM 1 here, we need to think long and hard, and designation is a
03:52:01PM 2 possibility." I think it continues to be, although that
03:52:04PM 3 is a future decision.

03:52:05PM 4 Q. Mr. Hoory, one last question. When you first started
03:52:10PM 5 seeking to retain Quinn Emanuel in late 2013, were you
03:52:13PM 6 committed to trying to resolve this case with Microsoft?

03:52:16PM 7 A. Absolutely. That was the whole point of meeting with
03:52:18PM 8 them on January 14th.

03:52:22PM 9 MR. WEAVER: Your Honor, at this point I don't
03:52:23PM 10 have any more questions, but I do want to now introduce
03:52:27PM 11 the administrative record into evidence, after Mr. Hoory
03:52:34PM 12 steps down.

03:52:42PM 13 THE COURT: All right. Anything else other than
03:52:44PM 14 the administrative record?

03:52:45PM 15 MR. WEAVER: No, your Honor. That is the balance
03:52:48PM 16 of our case. I did want to refer your Honor to a few
03:52:52PM 17 pages, though.

03:52:55PM 18 THE COURT: Please.

03:53:01PM 19 MR. WEAVER: Your Honor, I would refer you to
03:53:03PM 20 Exhibit 1, the first and second pages. This is a
03:53:18PM 21 certified administrative record. And I would offer it
03:53:20PM 22 into admission under Federal Rules of Evidence 803(8),
03:53:25PM 23 902(11).

03:53:34PM 24 THE COURT: All right. That will be admitted.

03:53:37PM 25 (Exhibit No. 1 was admitted.)

03:53:37PM 1 MR. WEAVER: Let me refer your Honor to a few
03:53:39PM 2 pages, just so they are in the record in case I don't get
03:53:42PM 3 to them with the limited amount of time we would have for
03:53:45PM 4 summations. Let me refer your Honor, maybe for later
03:53:51PM 5 reference in the record, to Page 126, part one. Can you
03:54:02PM 6 put that up on the screen, please? Page 126, please. The
03:54:22PM 7 reason I am going to refer you to that page is that, you
03:54:26PM 8 can see, is redacted. 6103. It is redacted because it
03:54:31PM 9 refers to another taxpayer there. We will be referring to
03:54:34PM 10 that either in closing summation or in further briefing as
03:54:38PM 11 evidence that this reg project did not start with
03:54:42PM 12 Microsoft.

03:54:44PM 13 Let me refer your Honor to a few other pages in the
03:54:47PM 14 few minutes I have left.

03:54:49PM 15 THE COURT: Hang on. Mr. Beck, do you want to
03:54:53PM 16 make a comment on that?

03:54:54PM 17 MR. BECK: Yes. This has nothing to do with the
03:54:56PM 18 examination of Mr. Hoory. Mr. Weaver just referred to,
03:55:05PM 19 "We can explain this in follow-on briefing." Given the
03:55:11PM 20 constraints we had today, in terms of timing, I don't
03:55:14PM 21 think that either one of us is going to have time to say,
03:55:17PM 22 "Here is the evidence that we couldn't present through
03:55:20PM 23 Mr. Hoory, but we, nevertheless, want your Honor to
03:55:22PM 24 consider." We certainly wouldn't have time to do that,
03:55:26PM 25 even if your Honor was going to entertain it.

03:55:29PM 1 What we would suggest, your Honor, and what we
03:55:32PM 2 contemplated was that we were going to be lucky if we were
03:55:35PM 3 to get done with Mr. Hoory today, but that the matter be
03:55:41PM 4 continued so that both parties can make written
03:55:43PM 5 submissions, where they submit the documents that they
03:55:47PM 6 believe the court should consider, as well as argument.
03:55:52PM 7 Your Honor indicated you didn't want to listen to me
03:55:57PM 8 present argument through Mr. Hoory.

03:55:59PM 9 That, or I suppose we could come back another day and
03:56:02PM 10 make our non-live testimony evidentiary presentations.
03:56:07PM 11 Although, I think both of us could probably do a better
03:56:09PM 12 job in writing than we would standing up here referring to
03:56:13PM 13 documents.

03:56:15PM 14 MR. WEAVER: Your Honor, if I may respond? My
03:56:18PM 15 intent here is to walk through this in five to ten
03:56:21PM 16 minutes, just so it is in the record. As far as we are
03:56:25PM 17 concerned, this should be it. Almost every single
03:56:29PM 18 innuendo and allegation that Microsoft made doesn't bear
03:56:32PM 19 out after you heard Mr. Hoory. So in terms of whether
03:56:37PM 20 they get discovery, I think that should be wrapped up.
03:56:41PM 21 But I agree on the issues of the reg, it is complicated,
03:56:46PM 22 and we are happy to have post-hearing briefing.

03:56:49PM 23 THE COURT: Counsel, I think that is the best way
03:56:51PM 24 of handling it. The administrative record is in the
03:56:54PM 25 record. It has been admitted, Mr. Weaver. It has been a

03:56:56PM 1 long day. Mr. Hoory talks a mile a minute, and it was
03:57:00PM 2 hard to follow up on all of that. Working for the IRS is
03:57:06PM 3 a good job for you. I think that Mr. Beck's suggestion
03:57:12PM 4 makes the most sense. It makes the most sense to me.

03:57:15PM 5 I may very well have some very specific questions for
03:57:18PM 6 both sides, in terms of what I want you to brief. So what
03:57:22PM 7 I propose is this: Let me think about what we heard today
03:57:26PM 8 in view of the material you have already submitted. Let
03:57:29PM 9 me see about what I want in terms of very specific
03:57:32PM 10 post-hearing briefing. We will notify the parties. Then
03:57:37PM 11 you can do the written submissions, respond to that, and
03:57:40PM 12 if the court feels it is necessary, we can bring you back
03:57:42PM 13 in and do oral argument as well. Does that make sense?

03:57:45PM 14 MR. WEAVER: Yes, your Honor.

03:57:47PM 15 MR. BECK: Yes. There are subjects that were just
03:57:50PM 16 inappropriate or ruled inappropriate to do with Mr. Hoory,
03:57:59PM 17 such as the circumstances surrounding the adoption of the
03:58:01PM 18 regulation. Whether you ask questions about that or not,
03:58:05PM 19 that is an important thing that we will want to explain,
03:58:07PM 20 the evidence that we do have on that and what the
03:58:09PM 21 implication of that is.

03:58:10PM 22 THE COURT: Absolutely. Some of those issues are
03:58:12PM 23 a matter of law. They have nothing to do with the facts
03:58:15PM 24 that were presented at the hearing today.

03:58:17PM 25 MR. WEAVER: Your Honor, if I could just clarify?

03:58:19PM 1 I am happy to brief, but I would ask that your Honor limit
03:58:22PM 2 the presentation of evidence to what got put in the record
03:58:25PM 3 today, so that the evidentiary hearing happens today, and
03:58:32PM 4 then we can brief the meaning of it --

03:58:32PM 5 MR. BECK: All we had time for today was one
03:58:34PM 6 witness. I had entire topics, such as all of the IRS
03:58:39PM 7 internal documents concerning the adoption of the
03:58:42PM 8 regulation. And this witness disclaimed any knowledge on
03:58:47PM 9 that. We are not able to present through this witness
03:58:54PM 10 documents that your Honor said he is not in a position to
03:58:59PM 11 testify about. So in order for us to make the evidentiary
03:59:02PM 12 showing on the other documents, we either have to do it in
03:59:06PM 13 writing, which I think makes the most sense, or we have to
03:59:09PM 14 come back another day and we can put on a document show.

03:59:12PM 15 MR. WEAVER: Your Honor, just let me respond to
03:59:15PM 16 that if I might. In terms of your order, if you go back
03:59:17PM 17 and look at the questions that deal with the regulation --
03:59:20PM 18 I think there were basically three. One was whether
03:59:23PM 19 notice and comment provisions had been complied with.
03:59:26PM 20 That is largely a legal issue. One was --

03:59:28PM 21 MR. BECK: Largely, but I've got a whole bunch of
03:59:32PM 22 exhibits, internal emails, that we want to present and
03:59:36PM 23 then argue from.

03:59:37PM 24 MR. WEAVER: Your Honor, that's what today was
03:59:39PM 25 about.

03:59:40PM 1 MR. BECK: Except I couldn't do it with the
03:59:42PM 2 witness.

03:59:42PM 3 THE COURT: Hang on a second.

03:59:45PM 4 MR. WEAVER: Second, there was an issue about
03:59:47PM 5 whether there was a reasoned analysis. Typically, your
03:59:49PM 6 Honor, unless there has been a showing -- a substantial
03:59:51PM 7 showing of bad faith, then you are supposed to decide
03:59:55PM 8 whether a reg is valid on the administrative record. And
03:59:58PM 9 in terms of whether there is a reasoned analysis, let's
04:00:02PM 10 argue that on the administrative record.

04:00:04PM 11 In terms of the timing of this reg, you heard from
04:00:07PM 12 Mr. Hoory. There is nothing but coincidence in terms of
04:00:10PM 13 the hiring of Quinn Emanuel and the reg.

04:00:13PM 14 THE COURT: Let me do this: Let me take some time
04:00:19PM 15 to absorb today in view of the documents already
04:00:24PM 16 presented, in view of the exhibits that I have not looked
04:00:28PM 17 at, and I will get back to you fairly quickly about
04:00:33PM 18 whether -- specifically what I want in terms of
04:00:36PM 19 post-hearing briefing. If the court feels there is
04:00:39PM 20 anything else that may be necessary, we will ask for that
04:00:43PM 21 as well. There are some issues that I believe are purely
04:00:49PM 22 matters of law. And that can be argued, as Mr. Beck
04:00:52PM 23 indicates, simply on the record that we already have. I
04:00:55PM 24 understand that not all of the testimony that Microsoft
04:01:00PM 25 may have wanted may have come in through this particular

04:01:02PM 1 **witness. We will see where we stand once I take a breath**
04:01:05PM 2 **and take a look at all of this.**

04:01:06PM 3 **All right? We are done today. Thank you all very**
04:01:12PM 4 **much.**

5 **(Proceedings adjourned.)**
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C E R T I F I C A T E

I, Barry Fanning, Official Court Reporter for the
United States District Court, Western District of
Washington, certify that the foregoing is a true and
correct transcript from the record of proceedings in the
above-entitled matter.

/s/ Barry Fanning
Barry Fanning, Court Reporter